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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

JERRAL W. JONES AND MICHAEL W. MCCOY,

Petitioners,

v.

BOB KLEIN AND GENEVIEVE KLEIN, JOHN FRANK PENDERGRASS, SAM THOMPSON, MARGARET SCHAFFER, CLYMER LAW, AND DONNIE HALL, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether the court of appeals erred in finding dispositive facts, and directing entry of a multimillion dollar judgment against petitioners, in a process that explicitly denied petitioners any right to present evidence or otherwise contest the factual findings in any court.

Whether the court of appeals' error, in making dispositive factual findings without a trial, so far departed from the accepted and usual course of judicial proceedings as to amount to a denial of due process and to call for an exercise of this Court's supervisory power.

PARTIES TO THE PROCEEDING

Petitioners are Jerral W. Jones and Michael V. McCoy. Respondents are Arkoma Production Company, a Delaware corporation ("Arkoma"), Arkla Exploration Company, a Delaware corporation ("AEC"), Arkla, Inc., a Delaware corporation, and a class of approximately 3,000 Arkansas oil and gas lessors ("royalty holders"), whose claims derive from oil and gas leases held by Arkoma.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioners Jerral W. Jones and Michael V. McCoy respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit from which review is sought is reported as *Klein v. Arkoma Production Company*, 73 F.3d 779 (8th Cir. 1996) (*"Klein II"*), and is set forth in the appendix ("Pet. App.") at 1a. The opinion of the United States District Court for the Western District of Arkansas is unreported and is set forth at Pet. App. 25a. A previous opinion of the Eighth Circuit is reported at 980 F.2d 521 (8th Cir. 1992) (*"Klein I"*) and is set forth at Pet. App. 83a. An earlier bench ruling of the district court is unreported and is set forth at Pet. App. 107a.

JURISDICTION

The judgment of the court of appeals was entered on January 9, 1996. Petitions for rehearing were denied on March 4, 1996. The Court's jurisdiction is invoked under 28 U.S.C. § 1254.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

U.S. Constitution, Amendment V:

> No person shall . . . be deprived of life, liberty, or property, without due process of law . . . .

Rule 52(a) of the Federal Rules of Civil Procedure:

> Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of [sic] the credibility of the witnesses.

STATEMENT

Respondent royalty holders brought this diversity case alleging that petitioners Jones and McCoy and other defendants had settled a gas "take-or-pay" claim and received proceeds in which the royalty holders were entitled to share. The court of appeals never afforded Jones and McCoy the opportunity to contest these factual allegations. Instead, the court of appeals *found* that Jones and McCoy had in fact settled the claim and had received settlement proceeds, and it held that they were therefore liable to the plaintiffs. It reached its findings in an extraordinary, two-step finesse.

First, in *Klein I*, Pet. App. 83a, the court reversed and remanded a district court decision that had granted summary judgment in favor of Jones and McCoy, and had dismissed all claims against them, on the ground that the royalty holders simply had no legal right to share in take-or-pay settlement proceeds. In its decision, the court recited the plaintiffs' allegations and assumed them to be true for purposes of reviewing summary judgment against them. Second, after a trial in which a different district judge found that Jones and McCoy did *not* in fact settle the take-or-pay claim or receive proceeds of any such settlement, the court of appeals reversed again, this time ruling that no trial should have been held after *Klein I* and that the district court must enter a multimillion dollar judgment against Jones and McCoy; the court held, over Judge Hansen's incredulous dissent, that it had (somehow) fully resolved the factual issues against Jones and McCoy on the prior appeal from a summary judgment in their favor. *Klein II*, Pet. App. 1a.

This extraordinary injustice warrants exercise of this Court's supervisory power. *See Dennison Mfg. Co. v. Panduit Corp.*, 475 U.S. 809 (1986).

Factual Background

Prior to December 31, 1986, Jones and McCoy owned all of the stock of Arkoma Production Company ("Arkoma"). Arkoma leased mineral rights from approximately 3,000 landowner-lessors, to whom it paid stipulated royalties based on sales of gas. It sold its gas to

Arkla, Inc. ("Arkla"), a pipeline company, under several take-or-pay contracts that required Arkla to buy or pay for specified quantities of gas at specified prices. As spot-market prices for gas declined in the early 1980s,[1] Arkoma and Arkla became embroiled in disputes over the terms and validity of the take-or-pay contracts, which they could not resolve.

On December 31, 1986, Jones and McCoy sold Arkoma to a wholly owned subsidiary of Arkla, Arkla Exploration Company ("AEC"). Two months later, the gas producer Arkoma, now indirectly owned by the pipeline Arkla, released Arkla from all past take-or-pay liability and agreed to amend the take-or-pay contracts; the amendments were similar to amendments that Arkoma had rejected when it was owned by Jones and McCoy. Pet. App. 54a.

Proceedings Below

In February 1990, the lessor royalty holders brought suit against Arkoma (their lessee), Arkla, and AEC, alleging that they were entitled to share in Arkoma's settlement of the take-or-pay claim. The plaintiffs also named Jones and McCoy, alleging that these defendants had been unjustly enriched because the price they had

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[1] *See generally Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos.*, 498 U.S. 211, 215-21 (1991).

received for Arkoma included proceeds of a settlement of Arkoma's take-or-pay dispute and, as royalty holders, the plaintiffs were entitled to a royalty share. Jones and McCoy moved for summary judgment on two grounds.

First, they argued that the documents showed, beyond dispute, that they had simply sold Arkoma, their wholly owned corporation, with all of its rights and obligations intact, that they were entirely within their rights in doing so, that they had no obligation or liability to Arkoma's lessors, and that the plaintiffs' claim, if any, was against their lessee, Arkoma, which settled the take-or-pay dispute only after it was owned by AEC. Second, Jones and McCoy argued (as did Arkoma) that in any event royalty holders have no legal right to share in take-or-pay settlements entered into by their lessees.

The district court concluded that Jones and McCoy's first contention raised factual issues that could not be resolved on a motion for summary judgment, but it granted petitioners' motion on the second ground, agreeing that royalty holders are not legally entitled to share in the proceeds of a take-or-pay settlement and dismissing all claims against Jones and McCoy. Pet. App. 116a. The district court thereafter held a bench trial only on certain other claims against Arkoma, AEC, and Arkla, and concluded that those claims were time-barred. Pet. App. 91a.

Plaintiffs appealed to the Eighth Circuit, which reversed the district court's pretrial summary judgment in favor of

Jones and McCoy, as well as its decision in favor of the Arkla entities. Before reaching the legal issues, the court recited as background the plaintiffs' allegations that, *inter alia*, Jones and McCoy settled Arkoma's take-or-pay claim and received proceeds from that settlement. Pet. App. 85a-91a. Then, as to Jones and McCoy, the court held, contrary to the district court, that Arkansas law *did* confer on royalty holders a legal right to share in the proceeds of take-or-pay settlements. Pet. App. 93a-103a. The court remanded the case for further proceedings. Pet. App. 105a.

On remand, a second district judge[2] conducted a bench trial on the plaintiffs' factual allegations -- namely, that Jones and McCoy had settled the take-or-pay dispute prior to or as part of their sale of Arkoma and had received proceeds from the settlement. After a five-day trial, the district court rejected these allegations in a 64-page opinion. The court found that Jones and McCoy did *not* settle the take-or-pay dispute, that Arkoma settled that dispute only *after* Jones and McCoy had sold it, and that the only proceeds Jones and McCoy had received were for the sale of their interests in Arkoma, not for Arkoma's later settlement of its take-or-pay dispute with Arkla. Pet. App. 50a-58a.

Plaintiffs again appealed. Unlike the first appeal, in which it dealt only with the district court's pretrial

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[2] Judge Morris S. Arnold, the original district judge, had been elevated to the Eighth Circuit.

dismissal on a purely legal ground, the court of appeals was now confronted with the district court's extensive factual findings in favor of petitioners, made after a five-day trial. But the court of appeals simply refused to consider these findings.

Instead, it ruled that the trial should never have been held, asserting that its own earlier decision in *Klein I* had already resolved the factual questions and that it was "law of the case" that Jones and McCoy had in fact settled Arkoma's take-or-pay claim and had received settlement proceeds. The court of appeals decided that the district court, on remand from the reversal of a summary judgment in *Klein I*, should merely have computed damages and entered judgment against Jones and McCoy. Indeed, the court of appeals went even further, not only deciding that Jones and McCoy's liability had been established by *Klein I*, but also prescribing the formula for computing damages (which would appear to dictate an award of somewhat more than $6 million), even though complex issues as to the computation of damages had yet to be tried, briefed, or argued in any court. Pet. App. 11a-12a.[3] The court remanded with instructions to enter judgment, leaving only the specific damages calculations to be performed by the district court. Pet. App. 17a.

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[3] The court also held that Jones and McCoy's liability was "primary" to the Arkla parties' liability, an issue that also was neither litigated in the district court, briefed, nor argued by the plaintiffs or petitioners in *Klein I* or in *Klein II*. Pet. App. 14a.

Judge Hansen dissented vehemently. He noted that *Klein I* could not possibly have disposed of the factual allegations against Jones and McCoy. First, he pointed out that "Jones and McCoy had no opportunity in the summary judgment setting to obtain a ruling from the district judge on the disputed issues of fact before the first appeal." Pet. App. 21a. He then stated that any findings by the court of appeals in *Klein I* would have constituted improper "appellate court fact-finding," Pet. App. 22a, but that in any event the court of appeals' assertion that there had been such findings in *Klein I* was entirely mistaken. He demonstrated that the statement of facts in the first appeal was merely a "recitation of the evidence as viewed in the light most favorable to the nonmoving plaintiffs at the time the trial court granted summary judgment against them." Pet. App. 22a. He concluded that elevating a mere recital of the plaintiffs' allegations -- given as background in deciding an appeal from summary judgment in favor of petitioners -- to the level of "law of the case" was "fundamental error," Pet. App. 21a:

> Nor are we now correct, and in truth we compound our error, when we take what was an unwarranted appellate court fact-finding, call it a "conclusion of law," and then use it as "the law of the case" to reverse carefully considered detailed findings of fact made by the district judge after hearing all of the evidence in a five-day trial. Our gratuitous finding (or "assumption" as the district judge more politely characterized it on remand) was not only

> unwarranted, ill-advised, and inappropriate, it was, as the district judge's meticulous fact-findings on remand demonstrate, clearly wrong.

Pet. App. 22a.

REASONS FOR GRANTING THE PETITION

Petitioners recognize that this Court does not sit to correct ordinary errors of a court of appeals. But there are extraordinary cases in which the lower court's error is so obvious, its effects are so significant, and (most important) the error stems so directly from the court's improper performance of its duties as a federal appellate court, that this Court should exercise its supervisory powers. *See Dennison Mfg. Co. v. Panduit Corp.*, 475 U.S. 809, 811 (1986) (per curiam) ("grant[ing] the petition for certiorari, vacat[ing] the judgment, and remand[ing] the case to the Court of Appeals for further consideration in light of Rule 52(a)"); *Anderson v. City of Bessemer City*, 470 U.S. 564, 566, (1985) (certiorari granted and judgment reversed where "Court of Appeals misapprehended and misapplied the clearly erroneous standard"); *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844, 858 (1982) (certiorari granted and judgment reversed where the "Court of Appeals erred in setting aside findings of fact that were not clearly erroneous"); *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 108 (1969) (granting certiorari to determine "whether the Court of Appeals

properly discharged its appellate function under Rule 52(a) of the Federal Rules of Civil Procedure").

This is such a case. The court of appeals, reversing two distinguished district judges and ignoring Judge Hansen's compelling dissent, denied petitioners a trial on the plaintiffs' central allegations, deemed them true, and directed the entry of a multimillion dollar judgment against petitioners. It did so by elevating its own recital of the plaintiffs' allegations in *Klein I*, where it was reviewing a grant of summary judgment dismissing their claims, into a finding of the facts in the plaintiffs' favor; it therefore deemed irrelevant the only actual trial, before the district court on remand from *Klein I*, in which the court squarely found in favor of petitioners on the same allegations.

As Judge Hansen explained:

> We committed fundamental error in Klein I when we included in the "FACTS" portion of the opinion the resolution of what everyone in the district court knew were hotly disputed fact issues -- "whether or when this take or pay contract was settled."

Pet. App. 21a. The court of appeals *could not* find facts in *Klein I*, because all that was before it as to Jones and McCoy was an appeal from summary judgment in their favor; the plaintiffs had not sought summary judgment, and there had yet to be any trial or evidentiary submission on their allegations against petitioners. But the court then

cemented the error in *Klein II*, by deeming its recitals of the plaintiffs' allegations on these "hotly disputed fact issues" (recitals that were of course perfectly proper if used only as background in considering summary judgment for defendants) as findings that somehow became "law of the case," fully immune from any challenge by Jones and McCoy at the trial on remand. As Judge Hansen said, the court's supposed "finding" in *Klein I* that petitioners received proceeds from settling Arkoma's take-or-pay claim "was an unnecessary and exceptionally inappropriate appellate court fact-finding, and we should candidly recognize it as such." Pet. App. 19a. Judge Hansen added that the court of appeals should be

> willing to take the same medicine we dose out and recognize our own errors when we make them . . . by now treating [the] prior finding [in *Klein I*] not as either established fact or as the law of the case, but as what it should have been -- a recitation of the evidence as viewed in the light most favorable to the nonmoving plaintiffs at the time the trial court granted summary judgment against them.

Pet. App. 20a, 22a.

For reasons never explained, the majority of the panel was unwilling to do this. The court of appeals evaded Rule 52(a) of the Federal Rules of Civil Procedure by saying that the question whether Jones and McCoy's sale of Arkoma settled Arkoma's take-or-pay claim was a

"question of law" to be decided by the court, Pet. App. 8a, and that that question had been resolved against Jones and McCoy in *Klein I*. It is crystal clear that the question whether a settlement occurred is one of fact under the controlling (Arkansas) law.[4] But even if some questions of law were involved in *Klein I*, there were "several basic factual inquiries" (*Graham v. John Deere Co.*, 383 U.S. 1, 17-18 (1966), cited in *Dennison Mfg.*, *supra*, 475 U.S. 810-11), that could not have been resolved without a trial, including whether the transaction documents dealt with Arkoma's take-or pay claim at all; if so, how they resolved it; and whether Jones and McCoy in fact received any amounts attributable to that resolution. Jettisoning the district court's findings on these factual points, without

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[4] *See T.K. Woods v. Hopmann Mach. Inc.*, 301 Ark. 134, 782 S.W.2d 363 (1990) (reversing grant of summary judgment because there was a genuine issue of material fact regarding whether the appellant had agreed to a final settlement); *Rowland v. Worthen Bank & Trust Co.*, 13 Ark. App. 139, 680 S.W.2d 726 (1984) (reversing and remanding matter to trial court for a factual determination of whether a settlement had occurred); *Williams v. Davis*, 9 Ark. App. 323, 659 S.W. 2d 514 (1983) (reversing trial court's factual finding that a settlement had occurred because finding was against the preponderance of the evidence); *Carder Buick-Olds Co. v. Wilson*, 1994 WL 693223 (Ark. App. 1994) ("the question of whether a settlement has been reached is one of fact"); *Dennis v. Keck*, 1994 WL 505235 (Ark. App. 1994) (finding genuine issues of material fact regarding whether the parties reached an agreement).

even suggesting that they were "clearly erroneous," was error warranting summary vacation and remand for further consideration. *See Dennison Mfg.*, *supra*, 475 U.S. 809.

This Court's Rules state that it will consider granting the writ where a United States court of appeals "has so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's supervisory power." Sup. Ct. R. 10(a); *see Gibson v. Lockheed Aircraft Service*, 350 U.S. 356, 357 (1956) (per curiam); *Thiel v. Southern Pac. Co.*, 328 U.S. 217, 225 (1946). That standard has been met here.

The right to present evidence to a neutral trier of fact on all contested material factual issues is of course at the very core of due process. *See Martin v. Wilks*, 490 U.S. 755, 762 (1989) (underscoring the "'deep-rooted historical tradition that everyone should have his own day in court.'" (quoting 18 C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 4449, p. 417 (1981)); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 327 n.7 (1979) ("It is a violation of due process for a judgment to be binding on a litigant who . . . has never had an opportunity to be heard"); *Hansberry v. Lee*, 311 U.S. 32, 40 (1940). It is not clear why the majority of the court of appeals' panel denied that right here.[5] What is clear is that the court of

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[5] In one respect, the majority misconstrued the prior history of the case. In responding to the dissent's criticism that the court was either improperly finding facts

(continued...)

appeals fundamentally misused the appellate process to short-circuit the trial process. Its "fundamental error" (Pet. App. 21a (Hansen, J. dissenting)) in managing its relationship with a lower court is one that can only be corrected by this Court.

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[5](...continued)
or incorrectly asserting that it had found the pertinent facts in *Klein I*, the majority said, "Notably, in *Klein I*, the district court had granted summary judgment in favor of Jones and McCoy on all claims except the breach of implied covenant to market claim. *Klein I*, 980 F.2d at 526. That claim was fully tried." Pet. App. 16a. That statement of the proceedings prior to *Klein I* is entirely incorrect: prior to *Klein I*, summary judgment had been granted before trial in petitioners' favor on all claims, and no issues had been tried against them.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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May 28, 1996

APPENDIX

APPENDIX A

United States Court of Appeals,
Eighth Circuit

No. 94-1353

Bob KLEIN; Genevieve Klein;
John Frank Pendergrass; Sam Thompson;
Margaret Schaffer; Clymer Law; Donnie Hall;
Wayne Franklin, Class Representative;
Glen Morris, Class Representative;
Rowland Vernon, Class Representative,
Appellants,

v.

ARKOMA PRODUCTION COMPANY;
Arkla, Inc.; Arkla Exploration Company;
Jerral W. Jones; Michael V. McCoy,
Appellees.

Submitted Jan. 11, 1995.
Decided Jan. 9, 1996.
Rehearing and Suggestions for Rehearing En Banc
Denied March 4, 1996 *

Natural gas royalty owners and lessors brought action against lessee and natural gas pipeline that purchased lessee, seeking royalty payments with respect to take-or-pay claim payments by pipeline, alleging breach of duty of fair dealing, breach of contract, tortious interference with contract, unjust enrichment, and breach of implied covenant to market. The United States District Court for the Western District of Arkansas, Morris Sheppard Arnold, J., dismissed action. Lessors and royalty owners appealed. The Court of Appeals, Van Sickle, Senior District Judge, sitting by designation, 980

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* Judge Hansen would grant the suggestions for rehearing *en banc*. Chief Judge Richard S. Arnold, Judge Loken and Judge Morris Sheppard Arnold took no part in the consideration or decision of this case.

F.2d 521, reversed as to unjust enrichment and breach of implied covenant to market claims and remanded. On remand, the District Court, Jimm Larry Hendren, J., entered judgment against owners and lessors. Owners and lessors appealed. The Court of Appeals, Beam, Circuit Judge, held that: (1) under law of the case doctrine, district court was not free to reject Court of Appeals' prior conclusion that sales agreements and supporting documentation respecting pipeline's purchase of lessee was partially settlement of lessee's take-or-pay claims against pipeline under gas purchase contract between lessee and pipeline; (2) under Arkansas law, owners and lessors were entitled to recover from lessee's stockholders on unjust enrichment claim seeking royalty payments with respect to take-or-pay claim payments by pipeline which were made as part of pipeline's purchase of lessee; (3) owners and lessors were entitled on their unjust enrichment claim against stockholders to one-eighth share of both $24 million payment and approximately half of $100 million payment made by pipeline to stockholders in connection with pipeline's purchase of lessee; and (4) lessee and stockholders breached implied covenant to market under leases, when they settled lessee's take-or-pay claims against pipeline as part of transactions involving pipeline's purchase of lessee, without making any payment to owners and lessors.

Reversed and remanded.

Hansen, Circuit Judge, dissented and filed opinion.

Bradley Jesson and Douglas Smith, argued, Fort Smith, AR, for appellant.

Jerry Canfield, Fort Smith, AR, argued, for Arkla/Arkoma.

Louis Cohen, argued, Washington, DC, for Jerral Jones.

Before BEAM, BRIGHT, and HANSEN, Circuit Judges.

BEAM, Circuit Judge.

Jerral W. Jones and Michael V. McCoy were sole shareholders of Arkoma, a natural gas production company which held leases with Bob Klein and other royalty owners. Jones and McCoy sold Arkoma (sometimes old Arkoma) to

Arkla, an exploration and pipeline company. Bob Klein and the royalty owners[1] appeal the district court's finding that they are not entitled to recover any portion of funds exchanged in the transaction. The district court, contrary to our earlier mandate, determined that Jones and McCoy had not settled the royalty owners' take-or-pay claims when Jones and McCoy effected the sale of Arkoma to Arkla and further determined that Arkoma had not breached any implied duties to the lessors. We reverse.

I. BACKGROUND

The facts of this case are set forth in our opinion in the earlier appeal of this action and need only be briefly repeated here. *See Klein v. Jones,* 980 F.2d 521, 523-25 (8th Cir.1992) *(Klein I).* Jones and McCoy were, as stated, sole shareholders of Arkoma, a gas production company. Arkoma had leases with the royalty owners (lessors) for mineral rights to property located in the Arkoma basin in western Arkansas. Under the leases, the royalty owners were entitled to one-eighth of the proceeds from gas produced on the owners' land. Arkoma received seven-eighths of the gas production proceeds for its "working interest."[2]

Arkoma sold natural gas to Arkla. One of Arkoma's contracts with Arkla (GPC 5239) had a take-or-pay provision.[3] Because the price of natural gas fell, Arkla was unable to "take" the gas at the agreed price and was

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[1] The named appellants represent a class of approximately 3000 lessors.

[2] Jones and McCoy, as individuals, also owned and controlled property in the Arkoma basin through several tax partnerships. These tax partnerships also leased mineral rights to Arkoma. This factual scenario appears more complicated than it is because Jones and McCoy wore many hats and because the transactions were structured to maximize tax benefits to Jones and McCoy.

[3] A take-or-pay provision is a clause in a gas contract that requires the purchaser to either take delivery of or to pay for the minimal contract volume of gas that the producer/seller has available for delivery. Under such a clause, the purchaser usually has the right to take gas paid for (but undelivered) in succeeding years (make-up gas). *Klein v. Jones*, 980 F.2d 521, 523 n. 1 (8th Cir.1992).

unwilling to "pay" for it. Accordingly, Arkoma had claims against Arkla for the amounts due under the take-or-pay provision of the contract. The claims amounted to approximately $36 million by March 1986 and were accruing at the rate of about $3 million per month.

In an effort to resolve the dispute over these claims, Arkla and old Arkoma embarked on a series of negotiations, ultimately resulting in the sale of Arkoma to Arkla. Jones and McCoy received $173 million as a result of the transaction.[4] After the purchase of Arkoma by Arkla, the disputed gas production contract (GPC 5239) was reformed. Under the new contract, Arkla paid new Arkoma (now wholly owned by Arkla) less for its gas, and consequently the royalty owners received lower royalty payments. The royalty owners were not aware of any of this until they received royalty checks at a lower rate in March 1987.

The royalty owners sued in district court for breach of the duty of fair dealing arising from a fiduciary relationship, breach of contract as third- party beneficiaries of the gas purchase contract, tortious interference with a contract, unjust enrichment and breach of implied covenant to market. The district court dismissed all claims. The royalty owners appealed to this court and we reversed the dismissal of the

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[4] That sum can be broken down as follows. The parties initially agreed that Arkla would pay at least $73 million for Arkoma, including the stock owned by Jones and McCoy. This amount was subject to an adjustment to account for the results of additional drilling on land subject to the leases. Most of Arkoma's interests in the wells were held in tax partnerships involving Arkoma and others, including Jones and McCoy. Before Arkla's purchase of Arkoma stock, Jones and McCoy acquired the tax partnership interests from others and assigned them to Arkoma. For the assignment of these interests to Arkoma, Jones and McCoy received a $35 million promissory note which was paid the day it was received. Jones and McCoy also received an agreement for Arkla to provide a quantity of gas to Jones and McCoy which agreement was secured by a promissory note for $24 million. Jones and McCoy sold their Arkoma stock to Arkla for $14 million. Additionally, in 1989, pursuant to the 1986 agreement that the amount was subject to an adjustment, Jones and McCoy received another $100 million for the revaluation of gas reserves. The royalty owners contend that they are entitled to one-eighth of the $24 million payment for the gas purchase contract and one-eighth of one-half of the $100 million payment.

unjust enrichment claim and the breach of implied covenant to market claim. *Klein I,* 980 F.2d at 533.

In Klein I, we determined as a matter of law that the complicated transactions between Arkla, Arkoma, Jones and McCoy for the purchase and sale of old Arkoma included some payment for the "settlement" of the royalty owners' take-or-pay claims. *Id.* at 525. ("The difference in the fair market value of the reserves [$.83 per mcf.] and the amount paid to Jones and McCoy [$1.62 per mcf.] represented the value paid to Jones and McCoy to settle Arkla's take or pay dispute under GPC 5239"). Noting that this case "cr[ies] for equity," we adopted the so-called "Harrell rule." *Id.* at 527, 531. Under that rule, oil and gas leases should be construed in a manner so that the lessee and lessor split all economic benefits arising from the land; a royalty should be due on either take-or-pay payments or settlement. *Id.* at 533 (J. Bright, concurring). We remanded to the district court for further proceedings consistent with the opinion.

On remand, the parties and the court agreed that the remaining claims were the royalty owners' unjust enrichment claims against Jones and McCoy[5] and the royalty owners' breach of implied covenant to market claim against Arkoma.[6] *Klein v. Arkoma,* No. 90-2060, Mem. Op. at 2-3 (W.D.Ark. Jan. 5, 1994). The district court found the record fully developed on the implied covenant to market claim but took further evidence on the unjust enrichment claim. *Id.* at 21.

After trial, the district court found:

> [t]here was no direct proof in the previous record on the question of whether Jones/McCoy had, in fact, settled a take-or-pay claim. It was, rather, for this

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[5] This equitable claim is against Jones and McCoy personally and not against Arkoma as a corporation because it was Jones and McCoy who received the benefit of the "premium" Arkla paid for the opportunity to reform the contract.

[6] This claim is essentially directed at old Arkoma. However, new Arkoma is the same corporation with a new stockholder, Arkla. Because Arkla owns Arkoma, Arkla may also be liable if Arkoma cannot satisfy a judgment.

> court on remand to hear the proof and determine what the facts are with regard to that issue. It is therefore unfortunate, in this court's view, that both the majority and concurring opinions in *Klein v. Jones,* assume that the sale of Arkoma from Jones/McCoy to Arkla amounted to a settlement of a take-or- pay claim existing between the parties. With respect, it is noted that the facts found by this court after a five day trial do not support that assumption.

Id. at 29-30 (emphasis in original) (footnote omitted). The district court found that the take-or-pay claim was not settled until after the sale of Arkoma because GPC 5239 was not reformed until after Arkoma (new Arkoma) was owned by Arkla. *Id.* at 30. The district court concluded that "Jones and McCoy were legally entitled to receive all they did receive from such sale. They had the legal right to sell their interests in Arkoma (including the [Arkoma] take-or- pay claim) and cannot be said to have been unjustly enriched because they chose to exercise that legal right." *Id.* at 35. On the breach of implied covenant to market claim, the district court found that the amendment of GPC 5239 "was prudent and reasonable and served to properly comply with the implied duty to market gas which New Arkoma, as lessee under the leases, owed to plaintiffs as lessors." *Id.* at 63.

The royalty owners have again appealed and the issue, once again, is whether the royalty owners are entitled to share in any portion of the $173 million that Jones and McCoy received from the various transactions. The royalty owners first contend that the district court failed to follow the mandate of this court on remand. They assert error in the district court's finding that the transaction at issue was not a settlement of the take-or-pay claim and assert that they are entitled to judgment on that claim. They also contend that the district court erred in determining that Arkoma had not breached an implied covenant to market.

II. DISCUSSION

A. "Settlement" Finding--Law of the Case

We agree with the royalty owners that the district court failed to follow the mandate of this court. The district court erred in determining that there had been no settlement of the take-or-pay claim. In *Klein I,* we ruled that the funds received by Jones and McCoy included an amount that represented the value to Arkla of its right to reform the take-or-pay contract. That amount was characterized as a "settlement" of the take-or-pay claims. The legal conclusion that Jones and McCoy settled the take-or-pay claims is the law of the case and the district court was bound to follow it.[7]

The law of the case doctrine prevents relitigation of a settled issue in a case and requires that courts follow decisions made in earlier proceedings to insure uniformity of decisions, protect the expectations of the parties and promote judicial economy. *Bethea v. Levi Strauss & Co.,* 916 F.2d 453, 456-57 (8th Cir.1990). *See also Liberty Mut. Ins. Co. v. Elgin Warehouse & Equip.,* 4 F.3d 567, 570 (8th Cir.1993). When a case has been decided by this court on appeal and remanded to the district court, every question which was before this court and disposed of by its decree is finally settled and determined. *Houghton v. McDonnell Douglas Corp.,* 627 F.2d 858, 864 (8th Cir.1980). The district court is bound by the decree and must carry it into execution according to the mandate. *Id.* It may not " 'alter it, examine it except for purposes of execution, or give any further or other relief or review it for apparent error with respect to any question decided on appeal.'" *Id.* (*quoting Thornton v. Carter,* 109 F.2d 316, 319- 20 (8th Cir.1940)). Under the law of the case doctrine, a district court must follow our mandate, and we retain the authority to decide whether the district

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[7] Generally, parties must bring any perceived errors in a panel opinion to the court's attention through a petition for rehearing. *Liberty Mut. Ins. Co. v. Elgin Warehouse & Equip.,* 4 F.3d 567, 571 n. 6 (8th Cir.1993). We note that no one disputed our characterization of the transactions as a "settlement" in the petitions for rehearing that were filed in the earlier appeal.

court scrupulously and fully carried out our mandate's terms. *Jaramillo v. Burkhart,* 59 F.3d 78, 80 (8th Cir.1995).

The district court erroneously concluded that our holding was a factual "assumption." It was not. It was a legal conclusion. We found that, as a matter of law (regardless of how the parties viewed the several agreements), the various transactions, including the ultimate reformation of GPC 5239, amounted, at least in part, to a "settlement" of the royalty owners' take-or-pay claims.[8] *Klein I,* 980 F.2d at 531-32.

The interpretation of an unambiguous contract is a question of law. *W.S.A., Inc., v. Liberty Mut. Ins. Co.,* 7 F.3d 788, 791 (8th Cir.1993). The determination that a contract is, or is not, ambiguous is also a legal determination and no deference is paid to the trial court's decision on the issue. *Maurice Sunderland Architecture, Inc. v. Simon,* 5 F.3d 334, 337 (8th Cir.1993). Also, in construing the contract, the court can consider both "the Agreement as a whole" and the "undisputed context in which the Agreement was concluded." *Realex Chem. Corp. v. S.C. Johnson & Son, Inc.,* 849 F.2d 299, 302 (8th Cir.1988) (emphasis in original). There was no dispute in the earlier litigation that the transactions surrounding the sale of Arkoma were the vehicles by which Arkla could reform GPC 5239.

As indicated, we concluded as a matter of law that the sales agreements and supporting documentation amounted to a settlement of the take-or-pay claims. In consideration of this settlement, Jones and McCoy received a premium, a price for the purported sale of Arkoma which was over

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[8] We note that the district court's rejection of our holding was based mainly on the sequence of events. The district court did not find that no settlement had ever taken place, but that the settlement did not occur until Jones and McCoy were out of the picture (when the gas purchase contract was reformed). The district court is wrong for two reasons: a) we rejected this argument in the first appeal; and b) finding that the actual reformation of the gas purchase contract is the settlement does not reflect economic reality. There was no consideration for the reformation. The *quid pro quo* to enable Arkla to renegotiate the contract was exchanged in December 1986 when Arkla bought Arkoma from Jones and McCoy. In other words, Jones and McCoy received the money, the "premium" to settle the take-or-pay claims.

and above the market value of its gas reserves and assets. *Klein I*, 980 F.2d at 531-32. Our legal conclusion that the transaction was a settlement was based upon the undisputed context of the negotiations leading up to the agreement: the parties viewed the transactions as part and parcel of an agreement to resolve the take-or-pay claims and the transactions resulted from the negotiations to resolve the take-or-pay dispute. We have again reviewed the record and remain convinced that our conclusion is correct.[9] In any event, the district court was not free to reject our legal conclusion.

B. Unjust Enrichment

The district court initially rejected the royalty owners' unjust enrichment claim on the ground that the royalty owners had a right to recover under their leases and therefore should not be entitled to an equitable remedy. *Klein v. Arkoma*, No. 90-2060 Preliminary Conference at 13 (Transcript of Findings) (W.D.Ark. March 4, 1991). We reversed that finding. *Klein I*, 980 F.2d at 533. Normally, when an express contract exists between the parties, unjust enrichment is not available as a means of recovery. *Moeller v. Theis Realty, Inc.*, 13 Ark. App. 266, 683 S.W.2d 239, 240

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[9] It is clear that the transactions amounted to a settlement of the potential claim. *See* Appellants' Appendix at 136 (November 25, 1986, Letter from Alan M. Warren, President of Arkla Exploration Co. offering to purchase Arkoma for $75 million dollars, including settlement of take-or- pay claims); Appellants' Appendix at 141 (Handwritten notes headed "Details of Proposed Deal" indicating "value to AEC [Arkla Exploration Co.] under lower pricing scenario approximately 50 mm$--Jones won't settle for less than 75mm$--portion of settlement must be take or pay . . . consultants have indicated that $.80/mcf is a 'reasonable' market value for reserves in the ground--have backed into portion of settlement which must be take or pay--24mm"); Appellants' Appendix at 152-157 (Arkla, Inc., Board of Directors' Meeting Minutes, December 17, 1986, containing numerous references to "take-or-pay" and citing elimination of take-or-pay obligation as a benefit of purchase); Appellants' Appendix at 158-179 (Documents presented at December 17, 1986, Board of Directors' Meeting entitled "Reformation of Arkoma Contract and Purchase of Arkoma Production Company"). All of this evidence was available to both the district court and to this court in *Klein I*. *See Klein v. Arkoma*, No. 90-2060 (W.D.Ark. March 4-12, 1991) (Trial Exhibits Nos. 51, 53, 58 and 72).

(1985). However, when an express contract does not fully address a subject, a court of equity may impose a remedy to further the ends of justice. *See, e.g., Roberson Enters., Inc. v. Miller Land & Lumber Co.,* 287 Ark. 422, 700 S.W.2d 57, 59 (1985) (imposing conditional cancellation). The leases in this case do not address whether a take-or-pay settlement fits within the definition of the "market value" of gas produced and sold under the leases.[10] Moreover, Jones and McCoy were not parties to the leases. For those reasons, we adopted the Harrell rule, and cited *Henry v. Ballard & Cordell Corp.,* 418 So.2d 1334, 1338 (La.1982) for the proposition that courts should construe transactions in such a way that the lessee and lessor split all economic benefits from the land. *Klein I,* 980 F.2d at 531-32.

A claim for unjust enrichment is an equitable claim. In matters of equity, the court is one of conscience which should be ever diligent to grant relief against inequitable conduct, however ingenious or unique the form may be. *Holland v. Walls,* 3 Ark.App. 20, 621 S.W.2d 496, 497 (1981). A court of equity may fashion any reasonable remedy that is justified by proof. *Mid-State Trust II v. Jackson,* 42 Ark.App. 112, 854 S.W.2d 734, 738 (1993).

Under Arkansas law, a party is unjustly enriched when he has received something of value that belongs to another. *Dews v. Halliburton Indus., Inc.,* 288 Ark. 532, 708 S.W.2d 67, 69 (1986). The measure of damages for unjust enrichment is the amount of unfair gain received by those unjustly enriched.[11] *See, e.g., Holland,* 621 S.W.2d at 499.

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[10] Under *Hillard v. Stephens,* 276 Ark. 545, 637 S.W.2d 581, 584-85 (1982), a lessor with a "market value" lease has a right to receive from the lessee a percentage of all proceeds the lessee receives from the sale of gas produced under a gas purchase contract. *See Klein I,* 980 F.2d at 533-34 (the settlement can be viewed as representing how much Arkla was willing to pay to either 1) be released from the contract or 2) pay for gas it had already received under the contract) (J. Bright, concurring).

[11] In this connection, we note that the only part of the monies exchanged in the transaction that flowed through Arkoma to Jones and McCoy was the $35 million to pay off the promissory note for the assignment of Jones's and McCoy's interests as lessors. All the other sums

Here, the evidence shows that Jones and McCoy received a "premium" from Arkla to enable Arkla to reform the gas purchase contract to the detriment of the royalty owners. The royalty owners never received any of the premium that Jones and McCoy received for the settlement of the take-or-pay claims.

Accordingly, because the evidence establishes as a matter of law that Jones and McCoy settled the take-or-pay claims, and because the Harrell rule entitles lessors to share in all proceeds from the land, we hold that the royalty owners are entitled to recover from Jones and McCoy on their unjust enrichment claim. We have reviewed the voluminous record in this case and can find no evidence that the royalty owners' rights or interests were separately considered in the negotiations between Jones and McCoy and the Arkla defendants. We thus conclude that the royalty owners' interest is subsumed within the "premium" that Jones and McCoy received as part of the sale.

We must next determine what part of the funds received by Jones and McCoy in the transactions represented the "premium" paid to enable Arkla to reform the contract. After review of the record, we find that the $24 million "gas contract" payment (secured by a promissory note) represented part of the "premium." [12] The royalty owners are entitled to a one-eighth share of that $24 million. In addition, pursuant to the 1986 agreement, Jones and McCoy received, in 1989, an additional $100 million for revaluation of wells. The evidence shows that the 1989 payment was premised on the 1986 agreement and it also includes part of the premium. The $100 million payment consists of payment of $1.62 for reserves in the ground which were worth $.83 on

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were paid directly to Jones and McCoy. The royalty owners do not claim entitlement to the $35 million payment.

[12] The evidence shows that the "gas contract" was actually an illusory contract. McCoy testified that "[t]here was actually no gas. There was no meter. There was no one selling and no one buying." Trial transcript at 714. This portion of the deal was apparently structured this way so that Arkla could pay in installments. *Id.* at 711-12. Jones and McCoy received monthly checks from Arkla for non-operational wells. *Id.* at 712-13.

the spot market. This difference represents the "premium" Arkla paid to reform GPC 5239. Accordingly, the royalty owners are entitled to one-eighth of approximately half ($.83/$1.62) of $100 million. On remand, the district court shall determine the amount with specificity and shall enter judgment against Jones and McCoy in that amount.[13]

C. Breach of Implied Covenant to Market

The district court found that evidence showed the actions of Arkoma in reforming the contract were prudent and reasonable. *Klein v. Arkoma,* No. 90-2060, Mem. Op. at 46 (W.D.Ark. Jan. 5, 1994). Although that finding may be correct, that is not the issue. We find that the implied covenant to market under a lease necessarily encompasses not only the duty to make prudent and reasonable business decisions, but the duty to share the proceeds of those decisions with the lessors. The breach in this case is neither the decision to settle, nor the decision to reform the contract, but the failure to share the benefits of the settlement with the beneficial owners of those proceeds.

This result is also mandated by our decision in *Klein I.* In adopting the Harrell rule, we held that the economic benefits of the land must be proportionally split between lessees and lessors of an oil and gas lease. Here, we determined that a "premium" was paid to enable Arkla to reform the contract. As noted earlier, the royalty owners received no share of the premium.

The district court erred when it conflated the cause of action for breach of lease obligations with that of breach of the gas purchase contract. The claim for breach of implied covenant to market arises under the lease. *Klein I,* 980 F.2d at 526. The district court, discussing the breach of implied covenant claim, states:

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[13] At oral argument, counsel for the royalty owners stated that the certified class in this case consists of only the Arkansas royalty owners. The Arkansas royalty owners comprise approximately seventy percent of the royalty owners entitled to share in the proceeds. Accordingly, the royalty owners in this litigation are entitled to approximately seventy percent of the award. The district court on remand shall also determine the proper amount to be awarded to these plaintiffs.

> As has been said by both the Court of Appeals and by this court, plaintiffs were incidental beneficiaries with respect to GPC 5239. Thus, these benefits incidentally acquired by plaintiffs when GPC 5239 came into being were in like manner incidentally lost when New Arkoma and Arkla, for prudent reasons, amended GPC 5239.

Klein, No. 90-2060, mem. op. at 44-45. The court further states that "[n]o authority has been cited to the Court to support the notion that the loss of such incidental benefits amounts to a violation of the implied covenant to market which attends a mineral lease." *Id.* at 60. After first noting that there is no express covenant to sue to enforce take-or-pay obligations under GPC 5239, the district court further states:

> Arkansas law does not recognize any implied covenant on the part of a lessee under an oil and gas lease to file suit to enforce the terms of a gas purchase contract, to which lessee is a party, for the benefit of the lessor under the said lease who is neither a party nor a third party beneficiary with respect to the said gas purchase contract.

Id.

In *Klein I*, we affirmed the holding that the landowners could not maintain a suit for breach of the GPC 5239 contract. *Klein I*, 980 F.2d at 527. However, the question of breach of implied covenant to market is a completely different issue. The implied covenant arises in and from the leases and is not premised upon GPC 5239, except that GPC 5239 may be evidence that defines the extent of the duty or that measures damages flowing from its breach.

To affirm the district court's holding would mean that the royalty owners' status as incidental beneficiaries of GPC 5239 precludes their claim to enforce an implied covenant to market under the leases. That result would effectively negate our earlier finding that there is such an implied covenant.

The flaw in the district court's implied covenant analysis is that it assumes that the only way to satisfy the implied

covenant would have been to sue to enforce the GPC 5239 take-or-pay obligations.[14] To the contrary, it may have been reasonable for Arkoma to forego suing Arkla on the take-or-pay claims for a premium reflected, as in this case, in the monies paid in the transactions involving the sale of the corporation. However, in order to fulfill its obligations to its lessors, Arkoma needed to ensure that the landowners received a portion of the funds paid by Arkla as a premium.

We hold that Arkoma breached a duty under the implied covenant to market owed to the lessors under the leases. This breach occurred when Arkoma failed to retain and pay over to the royalty owners a proportionate share of the premium paid by Arkla to settle the take-or-pay claims. Accordingly, the class is entitled to judgment against Arkoma under the implied covenant to market.

The liability here is primary as to Jones and McCoy and secondary against Arkoma. After all, Jones and McCoy actually received the monies rightfully belonging to the Arkansas royalty owners. *See supra* at 786 n. 11.

The dissent charges the court with three errors and then concludes that Jones and McCoy are entitled to $173 million while the owners of the land from which the gas is extracted are due zero dollars. The court disagrees and responds briefly to each concern.

The dissent first insists that we commit a factual error when we speak of the royalty owners take-or-pay claims, asserting that the claims belong only to Arkoma. *Infra* at 789-90. The significance of *Klein I* and its adoption of the Harrell rule is that the royalty owners are entitled, by virtue of the leases, to a proportionate share of Arkoma's take-or-pay claims. *Klein I,* 980 F.2d at 531-32. Also, the dissent, like the district court, confuses the royalty owners' contract rights under the leases with those under GPC 5239. *Supra* at 787-88.

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[14] To that end, there was much testimony about the value and prospect of success of the potential claim. That evidence is irrelevant because the value has already been determined by the amount Arkla was willing to pay to settle the potential claim. The prospect of success is likewise irrelevant since the claim was settled, not litigated.

Next, the dissent challenges both the fact of and the correctness of this court's finding in *Klein I* that a settlement had been reached. *Infra* at 790-91. That we found as a matter of law that the contracting parties had settled the take-or-pay claims is beyond dispute. Both the parties and the district court recognized this result on remand. *Klein v. Arkoma,* No. 90-2060, Mem. Op. at 30 (W.D.Ark. Jan. 5, 1994). In challenging the correctness of the decision, the dissent charges us with appellate court factfinding under the guise of deciding a question of law. *Infra* at 791. In doing so, the dissent disregards the trial court record and also misapprehends Arkansas law.

We strongly disagree that any appellate court findings of fact were made in either *Klein I* or in this decision. The dissent quotes statements by the district court in *Klein I* to show that settlement of the take-or-pay claims was in dispute. The dissent then turns the district court's legal observation that "I don't think the plaintiffs [royalty owners] have a right to any portion of the proceeds of a settlement of a take or pay obligation," into a "recognized . . . genuine factual dispute." *Infra* at 790. The basis for this legal/factual metamorphosis is difficult to perceive.

Admittedly, the settlement issue was hotly contested, but it was the legal question of whether and upon what terms a settlement was reached, rather than the facts surrounding the events of December 1986, that was in dispute. Resolution of the issue did not, and does not, involve deciding issues of fact. Whether a contract (here, the settlement agreement) is formed is a question of law. For example, if it is undisputed that party one says "I will give you ten dollars if you won't sue me" and party two says "okay", this court, or any court, is free to determine, as a matter of law, that the transaction constitutes a settlement calling for a payment of $10 to party two. That is exactly what this court did in *Klein I.* The court considered and relied upon undisputed documentary evidence that had been presented to the district court and found that the transaction amounted to a settlement. *Supra* at 785 n. 9. We merely construed unambiguous contracts in the context of undisputed facts, all the while viewing the evidence most favorably to the nonmoving parties. Within this context we

applied the Harrell rule to determine who would receive portions of the agreed upon amounts.

Building on its misapprehension of the factual/legal situation, the dissent cites *Rowland v. Worthen Bank & Trust Co.*, 13 Ark.App. 139, 680 S.W.2d 726, 728 (1984) as support for the proposition that "[u]nder applicable Arkansas law, whether or not a settlement was made is an issue of fact for the trier of fact." *Infra* at 791. The Rowland case simply does not stand for that proposition. The issue in *Rowland* was whether a lawyer, as a matter of law, may bind a client to an agreement [by the lawyer] to settle a claim. *Rowland,* 680 S.W.2d at 727. The trial court said no. *Id.* The Arkansas Court of Appeals reversed, holding that the settlement was, indeed, binding as a matter of law. *Id.* 680 S.W.2d at 728. The court conceded that the extent of the authority a client may grant to his lawyer may be a question of fact. *Id.* However, in *Rowland,* as here, when the context within which the settlement is achieved is not in dispute, whether a settlement was reached and the interpretation of the terms and conditions of such settlement are questions of law for the court. These questions are precisely what this court was entitled to answer and did answer in *Klein I.* These legal conclusions were binding upon the district court on remand.

The dissent's claims of appellate court factfinding appear to be bottomed on the posture of the appeal in *Klein I* as an appeal from a motion for summary judgment. *Infra* at 790. Notably, in *Klein I,* the district court had granted summary judgment in favor of Jones and McCoy on all claims except the breach of implied covenant to market claim. *Klein I,* 980 F.2d at 526. That claim was fully tried. *Id.* The evidence with respect to the threshold issue of whether the take-or-pay claims had been settled is the same with respect to all claims. As noted, all of the facts on which this court relied had been presented to the district court. *Supra* at 785, n. 9.

Finally, the dissent's objection to the court's covenant to market holding is incorrect as well. The dissent construes the various agreements and states, "I disagree with the court's basic conclusion that Jones and McCoy were paid anything as individuals to settle the take-or-pay dispute

between the two corporations, but instead were paid only for the value of Arkoma itself." *Infra* at 792. However, when you cut through the form and get to the substance of this dispute, as outlined *supra* at 783 n. 4 and 785 n. 9, you find, under the dissent's approach, that Jones and McCoy would have been paid $173 million for all of the stock in a $14 million company. Every dollar beyond the $14 million paid for the Arkoma stock represented payment for either the oil reserves owned by Jones and McCoy or the take-or-pay interests held by Jones and McCoy, as individuals, and by the royalty owners. If Jones and McCoy were entitled to direct or indirect compensation for their take-or-pay claims, so were the royalty owners. Thus, all of the maneuvering by Jones and McCoy to the contrary, the undisputed record simply fails to establish that the royalty owners had no lawful right to part of the settlement reached with Arkla.

III. CONCLUSION

For the reasons set forth above, the judgment of the district court is reversed and this action is remanded to the district court for entry of judgment against Jones, McCoy and Arkoma in an amount to be determined by the district court, together with interest as provided by law.

HANSEN, Circuit Judge, dissenting.

I respectfully dissent.

First, the court errs factually when it speaks of the "royalty owners' take- or-pay claims". *Supra*, at 782, 783. The only "take-or-pay claims" that existed in this case were those held by Arkoma against Arkla arising out of Arkla's refusal to either take or pay pursuant to one or more of eight gas purchase contracts (the most notable of which is GPC 5239) between the two corporations. The take-or-pay claims against Arkla were always contract rights and nothing more. The take-or-pay claim in GPC 5239 was not held by the plaintiffs, and most certainly not by Jones and McCoy as individuals, but solely by the plaintiffs' lessee, Arkoma. It was always a corporate asset of Arkoma's, a receivable, if you will, of disputed and doubtful value heavily laden with litigation risks. In the first appeal we held that the plaintiff royalty owners were not even third party beneficiaries of GPC 5239, holding them to be "at the most, incidental beneficiaries." *Klein v. Jones*, 980 F.2d 521, 527 (8th Cir.1992) *(Klein I)*. Their claims, if any, must be bottomed on their leases with Arkoma, and as I understand it, their unjust enrichment claims in this lawsuit are that Jones and McCoy failed to share with them some of the monies Jones and McCoy received when Jones and McCoy sold their individual interests in Arkoma to Arkla's wholly-owned subsidiary, Arkla Exploration Company. Or as the plaintiffs' counsel put it at oral argument, "They got theirs--we didn't get ours." [1]

Second, I most respectfully disagree with our court's first and basic premise that this court concluded as a matter of law in the first appeal that an identifiable and discrete part of the money Jones and McCoy received from the sale of

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[1] Contrary to the criticism made by my brothers, *supra*, at 788, 789, in my view the royalty owners are entitled to everything their leases entitle them by applying the "Harrell Rule" to let them share in the settlement of the take or pay contracts. As outlined herein, my dispute is with the court's adamant insistence that the first appeal decided as a matter of law that the take or pay contracts were settled by payments to Jones and McCoy and the terms of such a settlement.

Arkoma represented a "settlement" of the take-or-pay dispute between Arkla and Arkoma. If it was anything, our prior comment that "[t]he difference in the fair market value of the reserves and the amount paid to Jones and McCoy represented the value paid to Jones and McCoy to settle Arkla's take or pay dispute under GPC 5239," *id.* at 525, was an unnecessary and exceptionally inappropriate appellate court fact-finding, and we should candidly recognize it as such. It must be remembered that this case first came to us on a grant of summary judgment by the district court (Morris S. Arnold, J.) purely on a question of law. Whether the take-or-pay claim held by Arkoma against Arkla had in fact been settled by any of the payments made to Jones and McCoy was hotly contested in the summary judgment papers filed with the trial court. The district judge acknowledged the disputes of fact about the "settlement" of the take-or-pay claim that existed at the time of the submission of the summary judgment motion:

> The briefs are full of a lot of argument about whether or when this take or pay contract was settled, whether it was settled when Arkoma was sold and Mr. Jones and Mr. McCoy got money for their stock and some other things, or whether it was settled when in fact Arkoma entered into a new agreement with the Arkla companies.

(JM App. at 2-3.) Having recognized the genuine factual disputes before him about "whether or when this take or pay contract was settled," the district judge went on to say:

> But I don't think it matters, at least not on this level, when or if the contract was settled, because I don't think the plaintiffs have a right to any portion of the proceeds of a settlement of a take or pay obligation.

(*Id.* at 3.)[2] It was on that issue of law that we reversed the district court's grant of summary judgment to Jones and McCoy and adopted the "Harrell Rule." For our court to say today that "[o]ur legal conclusion that the transaction was a settlement was based upon the undisputed context of the negotiations leading up to the agreement . . .", *supra*, at 785 (emphasis added), is directly contrary to the record before the district court at the time it granted summary judgment and cannot be correct. Like the district court, it was not necessary "on this level" for this court to decide in *Klein I* "whether or when this take or pay contract was settled" (let alone what was paid to settle it, which is also what the court now says the first opinion did and what it is now trying to enforce). All we had to decide in *Klein I* was whether royalty owners had a legal entitlement to share in the settlement of a take or pay contract and leave to the district court on remand to determine the factual issues of what, when, whether, and how settlement occurred.

We consistently reverse district judges who decide disputed issues of fact in determining summary judgment motions. *See Teleconnect v. Ensrud,* 55 F.3d 357, 360 (8th Cir.1995) ("The summary judgment mechanism is not designed to forecast the work of the finder of fact."); *Oldham v. West,* 47 F.3d 985, 989 (8th Cir.1995). We should be willing to take the same medicine we dose out and recognize our own errors when we make them. We are not allowed on appeal to weigh the evidence and resolve disputed questions of fact. *McCurry v. Tesch,* 824 F.2d 638, 640 (8th Cir.1987)

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[2] The court's majority misreads this dissent. *Supra*, at 789. As stated above, the genuine factual disputes recognized by the first district judge were "whether or when this take or pay contract was settled." The only metamorphosis which occurs is when the majority takes those recognized and existing factual disputes as to "whether and upon what terms a settlement was reached," *supra*, at 789, and now says they were really questions of law decided by the first appeal. The real question of law involved in the first appeal was whether the first district judge was right when he said that royalty owners had no right to any portion of the proceeds of a settlement of a take or pay contract. We said that the district court was wrong, and that royalty owners, under the "Harrell Rule," have a right to share in the settlement of a take or pay contract between their lessee and a pipeline company. I do not disagree with that legal conclusion.

("The trial court is the place for the facts to be found. Appellate courts should not find the facts . . ."). Rather, on appeal from a grant of summary judgment as in *Klein I*, we are only authorized to view the evidence in the light most favorable to the nonmovant (not to determine what disputed facts that evidence proves) and then to decide whether the movant has "established its right to a judgment with such clarity as to leave no room for controversy. . . ." *Kegel v. Runnels*, 793 F.2d 924, 927 (8th Cir.1986). Under applicable Arkansas law, whether or not a settlement was made is an issue of fact for the trier of fact. *Rowland v. Worthen Bank & Trust Co., N.A.*, 13 Ark.App. 139, 680 S.W.2d 726, 728 (1984) ("The Court of Appeals cannot act as a factfinder. We must therefore reverse and remand this matter to the trial court so that a further hearing may be held to determine whether a settlement had been made. . . ." (citation omitted)).[3] We committed fundamental error in *Klein I* when we included in the "FACTS" portion of the opinion the resolution of what everyone in the district court knew were hotly disputed fact issues--"whether or when this take or pay contract was settled." Because Jones and McCoy had no opportunity in the summary judgment setting to obtain a ruling from the district judge on the disputed issues of fact before the first appeal, they were not and should not be bound on remand by our court's statements on the factual issues. *See International Union, UAW v. Mack Trucks, Inc.*,

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[3] Contrary to the majority's criticism, *supra*, at 788-89, *Rowland* is directly on point. In *Rowland*, as it was in this case with respect to the first appeal, only a question of law was before the appellate court. It was precisely because the Arkansas trial court had made no findings of fact about "whether, under the facts of this case, a settlement in fact had been made . . ." (680 S.W.2d at 728) (emphasis added) that the Arkansas appellate court remanded to determine if a settlement had in fact been made. At the risk of repetition, then District Judge Arnold, just like the state trial judge in Rowland, made no fact-finding about "when or if the contract was settled" (JM App. at 3), because, just like the state trial judge in Rowland, he decided the case on a question of law. The difference between our court and the Arkansas Court of Appeals is that the state appellate court correctly declined the opportunity to look at the facts in the record as they existed before the trial court and make the factual determinations that a settlement had, in fact, been made (and also its terms) as our court erroneously does.

917 F.2d 107, 110-11 (3d Cir.1990), *cert. denied*, 499 U.S. 921, 111 S.Ct. 1313, 113 L.Ed.2d 246 (1991).

Nor are we now correct, and in truth we compound our error, when we take what was an unwarranted appellate court fact-finding, call it a "conclusion of law," and then use it as "the law of the case" to reverse carefully considered detailed findings of fact made by the district judge after hearing all of the evidence in a five-day trial. Our gratuitous finding (or "assumption" as the district judge more politely characterized it on remand) was not only unwarranted, ill-advised, and inappropriate, it was, as the district judge's meticulous fact-findings on remand demonstrate, clearly wrong.

We can still correct rather than compound our previous error by now treating our prior finding not as either established fact or as the law of the case, but as what it should have been--a recitation of the evidence as viewed in the light most favorable to the nonmoving plaintiffs at the time the trial court granted summary judgment against them. Then we are free to do that which the law requires us to do now--review the findings of fact made by the district court on remand for clear error. Having done so, I would affirm the district court on the unjust enrichment claims made by the plaintiffs against Jones and McCoy.

I also dissent from the court's opinion with respect to the implied covenant- to-market claim made against the Arkla defendants. The court pegs its conclusion of liability on a determination that "Arkoma failed to retain and pay over to the royalty owners a proportionate share of the premium paid by Arkla to settle the take-or-pay claims." *Supra*, at 788. The "premium" the court is talking about is the "premium" the court erroneously finds Jones and McCoy were paid as individuals to settle the take-or-pay dispute pursuant to the terms of the December 31, 1986, transactions. *Supra*, at 786-87. Because I disagree with the court's basic conclusion that Jones and McCoy were paid anything as individuals to settle the take-or-pay dispute between the two corporations, but instead were paid only for the value of Arkoma itself, which included whatever present contingent asset value the take-or-pay dispute with Arkla may have had to Arkoma, I

cannot concur with the court's conclusion about Arkoma's responsibility to retain some of the monies paid by Arkla for the plaintiffs' benefit. In addition, any monies paid by Arkla went directly to Jones and McCoy without passing through Arkoma. There was nothing for Arkoma to "retain." In my view, the implied covenant-to-market claim only reaches the actions of New Arkoma in renegotiating its contract rights in GPC 5239. (The reader must remember that the plaintiffs had no legally enforceable rights in the contract and were only incidental beneficiaries thereof.) With respect to that issue, I agree with the district court that there was no violation of any such implied covenant. The actions taken by New Arkoma in negotiating an end to the stalemate were similar to those taken by many other producers with disputed take-or-pay contracts, and resulted in the movement of the plaintiffs' gas out of the ground at better than existing market prices with royalties being paid.[4] Its actions in renegotiating GPC 5239 meet the test we set out in *Klein I*-- "The test of compliance with an implied covenant is that of a reasonable developer." *Klein I*, 980 F.2d at 532. In fact, given the market conditions then existing, it probably would have been imprudent not to have renegotiated the contract. *See Frey v. Amoco Prod. Co.*, 603 So.2d 166, 176 (La.1992) (While making a long term contract containing a take-or-pay provision with pipeline company was originally prudent, producer "would also likely be deemed to have acted imprudently" if it failed to renegotiate in face of pipeline's financial inability to fully perform take or pay given market conditions.). Although the following quotation may be subject to the criticisms made herein, this court said as much in *Klein I*:

> In this case the take-or-pay elements in the developers [sic] contracts with the pipeline/marketer

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[4] The majority again errs in its reading of this dissent. Under the district court's judgment, which should be affirmed, the royalty owners received the benefit of the above market prices contained in the renegotiated take or pay contract which reopened their wells. For the first time since the take or pay dispute arose, they began receiving real dollars, not "zero dollars." They were receiving zero dollars, i.e., nothing, all the while the unresolved take or pay contract dispute between Arkoma and Arkla caused their gas to remain shut in and no production occurred.

> were, because of Federal Energy Regulatory Commission intervention, literally bankrupting the pipeline, and those facts must be considered in evaluating the reasonableness of defendants' actions. We find it reasonable for the defendants to make some effort to liquidate the take-or-pay obligations of AEC.

Klein I, 980 F.2d at 526. Plaintiffs have failed to show that the district court's fact-findings on this claim are clearly erroneous; the evidence fully supports the trial court's determination that no violation of the implied covenant to market gas in a reasonable and prudent manner occurred, and I would affirm its judgment in all respects.

Accordingly, I respectfully dissent.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

No. 90-2060

BOB KLEIN and GENEVIEVE KLEIN; JOHN FRANK PENDERGRASS; SAM THOMPSON; MARGARET SCHAFFER; CLYMER LAW and DONNIE HALL
Plaintiffs

v.

ARKOMA PRODUCTION COMPANY; ARKLA, INC.; ARKLA EXPLORATION COMPANY; JERRAL W. JONES and MICHAEL V. McCOY
Defendants

[Filed, Jan 05, 1994; U.S. District Court, Western District of Arkansas; Chris R. Johnson, Clerk; By ___, Deputy Clerk]

JUDGMENT

Now on this 5th day of January, 1994, in accordance with the accompanying Memorandum Opinion entered this date, Judgment is hereby entered for defendants in this matter and plaintiffs' claims of unjust enrichment as against Jones and McCoy and breach of implied duty to market gas as against the Arkla defendants are dismissed with prejudice.

IT IS SO ORDERED.

/s/ Jimm Larry Hendren
JIMM LARRY HENDREN
UNITED STATES DISTRICT JUDGE

[This document entered on docket in compliance with Rule 58 and 79(a), FRCP; ca 1/5/94; by Gail Ramsey]

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

No. 90-2060

BOB KLEIN and GENEVIEVE KLEIN; JOHN FRANK PENDERGRASS; SAM THOMPSON; MARGARET SCHAFFER; CLYMER LAW and DONNIE HALL
Plaintiffs

v.

ARKOMA PRODUCTION COMPANY; ARKLA, INC.; ARKLA EXPLORATION COMPANY; JERRAL W. JONES and MICHAEL V. McCOY
Defendants

[Filed, Jan 05, 1994; U.S. District Court, Western District of Arkansas; Chris R. Johnson, Clerk; By ___, Deputy Clerk]

MEMORANDUM OPINION

The action before the Court involves the trial and disposition of two unresolved issues remaining from an earlier trial between these same parties.

In *Klein v. Jones*, 980 F.2d 521 (8th Cir. 1992), the Court of Appeals reviewed and considered the decision of the U.S. District Court for the Western District of Arkansas [1] wherein, on Motions for Summary Judgment granted before trial, all claims against the defendants, Jones and McCoy, were dismissed and all claims against

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[1] The Honorable Morris Shepherd Arnold, then U.S. District Judge.

the Arkla defendants, except one claim based on an alleged breach of an implied covenant to market gas (hereinafter sometimes called "implied covenant claim"), were also dismissed; and wherein, after a bench trial lasting seven days, the said action based on the implied covenant claim was also dismissed as being time barred.

Following the discussion outline utilized by Judge Arnold at the district court level, the Court of Appeals carefully reviewed the evidence and discussed applicable law before determining, *inter alia:*

(a) that the district court's dismissal of all claims against the Arkla defendants (except the implied covenant claim) was correct and was affirmed;

(b) that the district court's refusal to dismiss the implied covenant claim as against the Arkla defendants, on motion and prior to trial, was correct and was affirmed; *but*

(c) that the district court's dismissal of the said implied covenant claim as against the Arkla defendants (after a seven day trial and based on the statute of limitations), was erroneous and was reversed; and

(d) that the district court's dismissal of all claims against the defendants, Jones and McCoy, was erroneous and was reversed.

The Court of Appeals remanded the case to this court [2] for "further proceedings consistent with this opinion." *Id.* at 533.

This court has, therefore, carefully reviewed the opinion of the Court of Appeals and attempted to conduct such further proceedings in accordance therewith as appeared to be not only consistent with the opinion

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[2] Hon. Jim Larry Hendren

but also necessary to the proper resolution of the remaining disputes between the parties. All parties and the court agree that the remaining disputes involve plaintiffs' unjust enrichment claim against Jones and McCoy; and plaintiffs' implied covenant claim against the Arkla defendants. Those further proceedings conducted by this Court included: (a) with respect to the implied covenant claim as against the Arkla defendants, a complete review of the transcript, orders and exhibits which formed the basis of Judge Arnold's earlier actions; and (b) a five day trial with respect to the unjust enrichment claim as against Jones/McCoy. [3]

It is the hope of this court that the parties, as well as any reviewing appellate court and/or others interested, will also review the said decision of the Court of Appeals (including the concurring opinion of Senior Circuit Judge Bright) before venturing further in their reading of this one.

Background

In stating the pertinent factual background necessary to an understanding of the issues to be decided, this court will adopt and utilize those facts mentioned in the opinion of the Court of Appeals except to the extent proof later heard by this court (which, obviously, was not available to the Court of Appeals) compels a different factual finding.

The named plaintiffs represent a class of some 3,000 royalty owners whose claims relate to certain oil and gas leases (hereinafter called "leases") on their properties located in the Arkoma Basin in Western Arkansas.

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[3] The court left it up to the Arkla defendants as to whether they wanted to be present and/or participate in the trial of the unjust enrichment claim. Except for a preliminary appearance, the Arkla defendants were not present and did not participate in said trial.

The defendants are Arkla, Inc. (Arkla), a corporation with its principal place of business in Shreveport, Louisiana; Arkla Exploration Company (Arkla Exploration), a corporation with its principal place of business in Shreveport, Louisiana; Arkoma Production Company (Arkoma), a corporation with its principal place of business in Fort Smith, Arkansas; Jerral W. Jones (Jones), an individual, and Michael V. McCoy (McCoy), an individual. As noted by the Court of Appeals, Arkla Exploration was, at all relevant times, a wholly-owned subsidiary of Arkla and functioned as the "in-house" exploration and production company for Arkla. Also, while not a named defendant, Arkla Energy Resources (Arkla Energy) was, at all relevant times, a division of Arkla and operated Arkla's pipeline.

Arkoma was initially incorporated and wholly owned by Jones and McCoy (hereinafter sometimes called Jones/McCoy) who later sold Arkoma to Arkla Exploration. While owned by Jones/McCoy, this corporation will simply be referred to as "Arkoma" and after its sale to Arkla Exploration, it will be referred to as "New Arkoma". Where context permits, the various Arkla entities may be referred to as "the Arkla defendants". Otherwise, they will, as appropriate, be referred to as "Arkla", "Arkla Exploration", "Arkla Energy", and "New Arkoma".

The leases under which plaintiffs claim were entered into between them and various lessees over a period of time dating back to the 1950s and typically provided for royalty payments to plaintiffs of "one-eighth of market value at the mouth of the wells of any gas sold or used from and/or off the leased premises".

By 1982, Arkla had acquired the leases and had thereby become the lessee under each of them. At that time, some wells had been drilled and were producing gas in the Arkoma Basin in Western Arkansas — particularly in

the two primary fields, Aetna and Cecil — but much of the lands covered by the leases were still undeveloped and their precise potential for gas production remained unexplored, undiscovered and, therefore, largely unknown.

On December 31, 1982, Arkla sold one-half of its leasehold interests in the Arkoma Basin, (*i.e.*, the lessees' rights under the plaintiffs' leases) to Arkoma under an agreement which provided, *inter alia*, for the following obligations and duties of the respective parties:

(a) Arkla, as seller, agreed:

(1) To transfer its interests, as lessee under plaintiffs' leases, to Arkoma;

(2) To enter into a gas purchase contract (GPC) whereby it would purchase a stated portion of any gas discovered by Arkoma on lands covered by plaintiffs' leases at fixed prices which could only be changed if Arkoma desired them to be changed.

(3) To agree to purchase, as a part of the contemplated GPC, a stated portion of any gas discovered by Arkoma in a five-state area (Arkansas, Louisiana, Texas, Oklahoma and Kansas) during the first five years of the GPC.

(4) To pay Arkoma, at the GPC price, for the gas produced during a year which should have been taken by Arkla under the GPC contract but which was not taken. (the take-or-pay provision)

(b) Arkoma, as buyer agreed:

(1) To pay Arkla $15,000,000 for Arkla's interest (as lessee) in plaintiffs' leases.

(2) To spend at least $30,000,000 in a drilling program over a four-year period in an effort to

locate gas believed to be under the lands covered by plaintiffs' leases.

(3) To sell to Arkla a certain portion of all gas dis covered in the Arkoma Basin (including the lands covered by plaintiffs' leases) as well as all gas discovered by Arkoma anywhere in the five-state area for a period of five years, with such sales to be in accordance with the GPC mentioned above.

After closure of the December 31, 1982, sale and in obedience to its terms which required Arkla to purchase gas from Arkoma, Arkla and Arkoma entered into certain gas purchase contracts, the most important of which was GPC 5239.

Under GPC 5239, as contemplated by the December 31, 1982 sale and as specifically bargained for by Arkoma, Arkla had the following important obligations:

(a) To pay Arkoma the maximum lawful prices called for under Sections 102 and 103 of the Natural Gas Policy Act of 1978 (NGPA) for gas produced from new wells drilled in the Aetna and Cecil Fields in the Arkoma Basin, as well as from any other acreage acquired by Arkoma.[4]

(b) To take, during a calendar year, at least 75 percent of the total daily deliverability of gas from the wells in question, or failing to so take, to pay for that minimum amount of deliverability.

GPC 5239 also provided that only Arkoma could renegotiate the contract price or other provisions during the term of the contract.

The problems leading to this litigation arose principally because two unexpected things then happened — (1)

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[4] These prices were then $3.83 per million cubic feet (mcf) and $3.00/mcf, respectively.

Arkoma's aggressive drilling program achieved a success rate in locating gas in excess of 90 percent as compared to an industry standard of only approximately 50 percent, with the result that Arkoma had unexpectedly large quantities of gas which Arkla was contractually obliged to either take at a fixed price or, if not so taking it, to nevertheless pay for it at that same fixed price; and (2) as a result of factors beyond the control of either of the parties, the market for natural gas was over-supplied and prices were declining with the result that Arkla found it was not economically feasible to either take the gas, pay for it and sell it, or not take it but nevertheless pay for it anyway.

The Court of Appeals quoted the U. S. Supreme Court's discussion of the factual background which caused the problems in the gas industry, as follows:

> In response to the ongoing natural gas shortages, Congress enacted the Natural Gas Policy Act of 1978 (NGPA), which, *inter alia*, established higher price ceilings for "new" gas in order to encourage production and carried over the pre-existing system of "vintage" price ceilings for "old" gas in order to protect consumers. However, recognizing that some of the vintage ceilings might be too low, Congress, in Section 104(b)(2) of the NGPA, authorized the Federal Energy Regulatory Commission to raise them whenever traditional pricing principles under the Natural Gas Act of 1938 (NGA) would dictate a higher price. After the new production incentives resulted in serious market which, among other things, collapsed the existing vintage price categories into a single classification and set forth a single new ceiling that exceeded the then-current market price for old gas; established a "Good Faith Negotiation" (GFN) procedure that producers must follow before they can collect a higher price form current pipeline customers, whereby producers may in certain circumstances abandon their existing obligations

> if the parties cannot come to terms; and rejected suggestions that the Commission undertake to resolve in the Order No. 451 proceeding the issue of take-or-pay provisions in certain gas contracts. Such provisions obligate a pipeline to purchase a specified volume of gas at a specified price, and, if it is unable to do so, to pay for that volume. They have caused significant hardships for gas purchasers under current market conditions.
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> *Mobile Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos.* 498 U.S. 211, ____, 111 S.Ct. 615, 617, 112 L.Ed.2d 636 (1991).

Id., 980 F.2d at 523.

The testimony in this case supported the Supreme Court's notions about the effect of the NGPA. It showed that artificially low controlled gas prices in the 1960s and mid-1970s created a demand for natural gas which exceeded the existing supply. To meet this situation, Congress adopted the NGPA in 1978 which, as stated by the Supreme Court, maintained low prices for old gas but allowed significantly higher prices for new supplies of gas. In response to the shortages, pipelines entered into gas purchase contracts in which they had bid to pay maximum lawful prices under the NGPA for new gas and in which they made substantial commitments to gas producers, including substantial commitments regarding deliverability of gas which the producers committed to the purchase contracts. By the mid-1980s, demand had decreased and supply had increased to the point that the pipelines could not take the substantial volumes of gas which were available for production and could not dispose of produced gas at the prices called for in their contracts. Due to the pipelines' control of the transportation of gas, the Federal Energy Regulatory Commission required, by its order No. 436, that nondiscriminatory access to the pipelines be allowed so that gas could reach the ultimate consumers at significantly lower prices than

were provided for by the long term contracts which had been entered into in the late '70s and early '80s. Order No. 436 compounded the pipelines' take-or-pay problems by allowing free access to the pipelines for the transport of gas subsequently sold at significantly lower prices thereby even further reducing the ability of the pipelines to dispose of gas at the high prices for which they had contracted.

The proof showed that the initial transaction between Arkoma and Arkla, in 1982, ultimately placed Arkla in the precise position discussed above. Arkla, seeking additional gas reserves to meet its supply obligations which had experienced severe curtailments throughout the '70s, entered into the 1982 transaction with Arkoma whereby the latter was committed to spend up to 30 million dollars to develop acreage in the Arkoma Basin in Western Arkansas. To protect its investment and to justify its risk, Arkoma insisted upon favorable provisions in GPC 5239. Thus, when the market became glutted and gas prices fell, Arkla found itself in the difficult position which was common to many producers in the nation.

Commencing in 1985, and continuing into 1986, Arkla reduced the amount of gas it took from Arkoma but did not honor the take-or-pay provisions of GPC 5239. Arkoma responded by pointing to the take-or-pay features of GPC 5239 and by demanding that Arkla either take the contractually required amount of gas and pay for it per the contract, or that Arkla pay for the untaken amount of gas at the contract price and take it at a later date. Arkla repeatedly declined to do either and, although GPC 5239 provided that only Arkoma could renegotiate the contract, insisted that GPC 5239 be changed (a) to reduce the gas prices to then market levels; (b) to eliminate the five-state dedication; (c) to eliminate the 75% take provision; and (d) to eliminate the take-or-pay provision as well as any allegedly accrued obligation thereunder.

The demands of Arkoma on Arkla finally took the form of a billing to Arkla for a claim of some $36,000,000 for alleged take-or-pay obligations of Arkla under GPC 5239 through March of 1986. The claim further alleged that, based on then current rates of take by Arkla, the take-or-pay accrual would be approximately $3,000,000 per month thereafter.

Arkla did not formally respond to this take-or-pay billing nor did it make any payments to Arkoma with respect to it. Instead, Arkla entered into negotiations with Jones/McCoy, as principals of Arkoma (Chairman of the Board and President, respectively, and together the sole stockholders of Arkoma). While the alleged accrual of the take-or-pay obligation was a major concern prompting the negotiations, the proof indicates Arkla was also very much concerned about its ongoing take obligations, at high, fixed prices, under a contract which could not be changed or altered unless Arkoma in initiated negotiations in that regard. These negotiations involved discussions of several alternatives — so many, in fact, that the process was described by one witness as being "a deal-a-day." These possible alternatives included, *inter alia*:

(a) permanently capping the gas price, thereby avoiding the automatic price escalation feature under Section 102, NGPA;

(b) a prepayment, recoupment approach, whereby Arkla would pay Arkoma for the gas and then recoup its investment as and when the gas was actually produced and marketed;

(c) seeking new markets for Arkoma's gas at higher prices than Arkla was willing to pay;

(d) some sort of a "buy-down" by Arkla without any right to recoup the payment by later receipt of gas from Arkoma;

(e) the assignment or transfer of certain reserves from Arkla to Arkoma;

(f) allowing Arkoma to transport gas via Arkla's pipelines free of charge;

(g) transferring Arkla stock to Arkoma in exchange for settlement of the take-or-pay and future problems;

(h) having Arkoma acquire Arkla's interests (presumably in the contract and the wells covered by it); and

(i) having Arkla acquire Arkoma's interests (again presumably in the contract and the wells covered by it) which would then permit Arkla to reform the contract.

Although the negotiators obviously did not dwell on it, litigation was certainly an alternative.

These so-called "deal-a-day" negotiations were not fruitful and there came a time when Arkla began to entertain the notion of simply trying to buy Arkoma — lock, stock, and barrel — as a way to solve all of its problems. It seemed apparent that as long as Jones/McCoy owned and controlled Arkoma, there could be no resolution of the GPC 5239 problems which Arkla could accept.

After Arkla broached the "purchase" alternative to Jones/McCoy and they indicated some interest, the evidence indicates there were very few references by the parties to the settlement of disputes between Arkla and Arkoma relative to GPC 5239. Instead, the negotiations then focused on the evaluation of Arkoma and what it would take for Arkla to become the owner and controller of it.

In the negotiations relative to the possible sale of Arkoma to Arkla, Jones/McCoy were asked (not as officers or directors, but as owners and stockholders) to state the figure they desired in exchange for all their

right, title and interest in the corporation. Although it would seem obvious that GPC 5239 (and Arkoma's rights under it — including take-or-pay) was one of the principal assets owned by Arkoma, there was no evidence that Arkla and Jones/McCoy discussed what value should be placed on this all-important contract. Instead, the negotiations related to the total value to be placed on the company being purchased, by analyzing the value of fixed assets such as equipment, vehicles, etc.; determining the value of current production, (*i.e.*, gas which was in a deliverable state); and the potential value of undeveloped reserves owned by Arkoma under existing leases.

By letter of November 19, 1986, Jones proposed a purchase price of $75,000,000 plus $1.50 per mcf for each additional mcf of gas disclosed by a re-evaluation of the gas reserves of certain recently drilled wells ("Category I Wells") as well as $1.50 per mcf for each additional mcf of gas to be discovered by Jones/McCoy in additional wells ("Category II Wells") to be drilled by them in a "prove up" period [initially one year (1987) but later extended by agreement]. This letter (Plaintiffs' Exhibit 50) also mentioned that up to 25 percent of the total purchase price "could be paid to the stockholders as take-or-pay."

By answering letter of November 25, 1986, Arkla counter-offered with a purchase price of $75,000,000 plus $1.25 per mcf for Category I Wells production and $1.00 per mcf for Category II Wells production. This letter (Plaintiffs' Exhibit 51) mentioned that Arkla ". . . retains the option to include as a part of the $75,000,000 offer up to $35,000,000 in the form of a five-year contract extension for two billion cubic feet (bcf) per year of gas at $3.50 per mcf in the resolution of outstanding take or pay claims against Arkla. . . ."

Although neither of these proposals was accepted by both, the parties nevertheless did reach an agreement in

December of 1986 and Arkoma was sold to Arkla Exploration by Jones/McCoy on December 31, 1986. In final form the agreement required Jones/McCoy to be paid, as of the closing date, a total of $73,000,000 as follows:

(a) Arkla Exploration would pay Jones/McCoy $14,000,000 in cash for the Arkoma stock;

(b) Arkla Exploration would pay Arkoma's $35,000,000 note to Jones/McCoy which note had been given by Arkoma in payment of income rights owned by Jones/McCoy under certain tax partnerships which had been set up to provide money for exploration costs and to divide income from wells drilled, if and when the same should be in production;

(c) New Arkoma was to furnish Jones/McCoy 5.8 bcf of gas free of charge over a five-year period;

(d) Arkla Exploration was to purchase from Jones/McCoy the said 5.8 bcf of gas so supplied to them by New Arkoma at prices beginning at $4.77 per mcf in 1977 and escalating to $6.08 per mcf in 1992, for a net present value purchase price of $24,000,000. This obligation was to be secured by a $24,000,000 note from Arkla Exploration to Jones/McCoy.

In addition to the said $73,000,000 to be paid at the time of closing, New Arkoma was to pay Jones/McCoy at the rate of $1.62 per mcf for any newly established additional reserves which might be found by them during the agreed-upon "prove-up" period of one year after the sale.

Jones/McCoy received payment of the $14,000,000 cash at closing on December 31, 1986; they also then received $35,000,000 in payment of the Arkoma promissory note; and, in due course and prior to the expiration of five years, they were supplied the 5.8 bcf of gas which was, in turn, purchased from them by Arkla

Exploration at a total cost of $24,000,000. This served to satisfy the gas purchase contract and the promissory note given by Arkla Exploration to secure it.

Additional wells (the Category II Wells) were drilled by New Arkoma pursuant to the directions of Jones/McCoy in accordance with the December 31, 1986 agreements, and large quantities of gas were discovered. A controversy then arose between Jones/McCoy and New Arkoma concerning the actual amount of the gas which was to be paid for at the rate of $1.62 per mcf in accordance with the December 31, 1986 agreements, but this dispute was resolved in 1989 when Arkla Exploration paid Jones/McCoy an additional $100,000,000 which was payment for reserves, the balance due on free gas and interest.

The evidence indicated that after the drilling costs and other expenses were deducted, as incurred by Jones/McCoy during the "prove-up" period, Jones/McCoy netted some $160,000,000 from the sale of Arkoma to Arkla pursuant to the December 31, 1986 agreements.

After Arkoma was sold to Arkla Exploration and thereby became New Arkoma, and on February 13, 1987, Arkla Exploration, Arkla Energy and New Arkoma entered into an agreement whereby GPC 5239 was amended. Under the amendment, the contract price for gas was reduced from $3.83 per mcf to $2.20 per mcf and provision was made to release gas on the spot market for sale at prices in the neighborhood of $1.50 per mcf.

This litigation then ensued and, as heretofore stated, Judge Arnold's disposition of all issues in the case except the unjust enrichment claim and the implied covenant claim, were affirmed by the Court of Appeals in *Klein*, 980 F.2d at 521.

The Court of Appeals opined in its decision that any rights of the plaintiff royalty owners must grow out of

their leases and this court both agrees with and feels bound by that opinion. Accordingly, it is useful to examine those leases in detail to determine what they provide; what the plaintiffs could expect to receive under them; and to determine what actions by the Arkla defendants, Arkoma or Jones/McCoy, if any, may have damaged or impaired those rights of the plaintiffs.

The leases in question relate to property located in the Arkoma Basis in Western Arkansas. Thus, this federal court sitting in Arkansas is obliged to consider the leases and their application under the laws of the sate of Arkansas. *See Young v. Ethyl Corp.*, 382 F. Supp. 769 (W.D. Ark. 1974), rev'd on other grounds, 521 F.2d 771 (8th Cir. 1975).

It is said to be "hornbook law" that oil and gas leases are construed in favor of the lessor, if for no other reason than that the lessor is the uninformed and inexpert party to the bargain. *Klein*, 980 F.2d at 531 (*citing* Summer's Oil & Gas Perm Edition Vol. 2 at 372). However, Arkansas courts have held that the rules that a contract should be construed mostly strongly against the party preparing it and that oil and gas leases are to be construed in favor of the lessor and against the lessee are to be applied only where the contract is susceptible to different interpretations, and should not be used to overturn plain and unambiguous terms of the contract. *Bodcaw Oil Co. v. Atlantic Refining Co.*, 217 Ark. 50, 61, 228 S.W.2d 626, 633 (1950). Arkansas courts have also stated that an implied covenant is one that may be reasonably inferred from the whole agreement and the circumstances attending its execution but that such covenants are not favored by the law and can be justified only upon the ground of legal necessity arising from the terms of the contract and the circumstances attending its execution. *Amoco Production Co. v. Ware*, 269 Ark. 313, 320-321, 602 S.W.2d 620, 623 (1980) *citing* 20 Am. Jr.2d, Covenants § 121. In considering an oil and gas

lease on Arkansas lands, the U.S. District Court for the Western District of Arkansas (Hon. John E. Miller) has stated that a covenant should not be implied or created to satisfy the desires of the lessor and especially to meet a situation that was not in the minds of either the lessor or lessee at the time the lease was executed. *Wood v. Arkansas Fuel Oil Co.* 40 F. Supp. 42, 46 (W.D.Ark. 1941). Thus, while the inquiry may not *stop* with the lease language, it nevertheless most certainly must *start* with the language of the leases.

A typical lease [5] held by plaintiffs in this case contains, *inter alia*, the following provisions:

> 1. The lease is for a term of ten (10) years and as long thereafter as gas is produced from said land. If there is no production of gas at the end of the term but lessee has then commenced operations for drilling, in good faith, the lease shall nevertheless continue in effect as long as such operations continue and, if there is production of gas pursuant to the drilling, as long as the production continues. [para 2]
>
> 2. Lessee is to pay lessor, as royalty on gas produced from the land and sold or used by lessee off the land, the market value at the mouth of the well of one-eighth (1/8) of the amount realized from such sales. [para 3(b)]

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[5] *e.g. See* Plaintiffs' Exhibits 205 and 206. The Court of Appeals noted that some leases initially involved in this controversy were so-called "fixed rate leases" which called for royalty payments based upon a fixed price for gas as opposed to a market value for gas and that these leases had been converted into market value leases in separate state court litigation (*Glen Morris, et al, v. Arkansas Louisiana Gas Company, et al.*, In the Chancery Court of Franklin County, Arkansas, Charleston District, No. E-86-40. *Final Order*, Filed on May 21, 1990). Accordingly, this court will not differentiate between the "fixed rate" and the "market value rate" leases but will treat them the same for purposes of rendering its opinion in the case.

3. Where gas is not sold or used due to a lack of market or any other reason beyond the reasonable control of lessee, lessee may pay lessor as royalty $100 per well per year until the gas can be profitably produced and marketed and if this payment is made, it shall be considered that gas is being produced within the meaning of paragraph 2 of the lease. [para 3(b)].

4. If drilling operations are not commenced on the leased land on or before one (1) year form the date the lease commences, the lease shall terminate unless on or before such anniversary date of the commencement of the lease, lessee shall pay to lessor a delay rental of $1.00 per acre for each acre for each acre of land subject to the lease, which payment shall maintain lessee's rights under the lease, as to all such land, without the commencement of operations for the period of one (1) year. This delay rental can continue to be paid with the same effect during the primary term of the lease. [para 4].

5. The estate of either party under the lease may be assigned in whole or in part and the covenants of the lease shall extend to the heirs, executors, administrators, successors and assigns of the parties. [para 9].

6. If the lease is assigned in whole or in part, Lessor shall look solely to the assignee for the performance of this lease as to the interest assigned. [para 9].

7. Lessee has the right at any time to release and surrender the lease by delivering to Lessor or placing of record in the office of the Circuit Clerk in the County where the leased land is situated, a release describing the lands to be surrendered and, as to such lands, Lessee shall thereupon be relieved of any and all obligations under the lease. [para 9].

8. A failure to pay or tender rentals in accordance with the terms of the lease shall be construed as a relinquishment of the lease. [para 9].

9. All express and implied covenants of the lease, both before and after production, shall be subject to all Federal and State laws, executive orders, rules and regulations and, notwithstanding anything in the lease to the contrary, the lease shall not expire, terminate or be forfeited in whole or in part, nor shall Lessee be liable for damages for failure to comply with any of said covenants so long as or if compliance therewith is hindered, delayed or prevented by such law, order, rule or regulation. [para 10].

If compliance with the provisions of this lease, both expressed and implied, is hindered, delayed or prevented by reason of any such law, order, rule or regulation at the expiration of the primary term hereof, the primary term shall be and the same is hereby extended for the full term of such hinderance, delay or prevention and for a period of one (1) year after such law, order, rule or regulation causing or resulting in the delay, hinderance or prevention has become wholly ineffective. [para 10].

Prior to the discovery of gas upon the leased premises, the extension herein granted shall be ineffective unless Lessee shall, before the expiration of the primary term of the lease term and during the period of such hinderance, delay or prevention, continue to pay or tender the annual delay rentals hereinabove mentioned on each anniversary rental paying date as the same become due and payable or until drilling operations are commenced or production of gas is obtained in accordance with the other provisions of this lease, and the payment or tender of such rentals at such times shall have the same force and effect as rental payments paid or tendered during the primary term. [para 10].

> If rental payments have been suspended during the primary term under the terms of this lease by reason of the commencement of operations for drilling or on account of the production of gas prior to the time Lessee is hindered, delayed or prevented by any such law, order, rule or regulation, Lessee may resume the payment or tender of the annual delay rental on the rental date next ensuing after Lessee has been hindered, delayed, or prevented from complying with the provisions of this lease, as aforesaid, and the resumption of the payment of delay rentals shall have the same force and effect as though rentals had been continuously paid on each rental paying date and by continuing such rental payments Lessee may extend the lease beyond the primary term for the full period hereinabove mentioned. [para 10].

Notwithstanding its obvious reservations about implied covenants, the *Ware* court determined that certain implied covenants must accompany every mineral lease. These implied covenants are as follows:

> 1. A covenant to drill wells within a reasonable time, testing the land for oil and gas;
>
> 2. a covenant to drill test wells within a reasonable time after notice;
>
> 3. a covenant, if oil and gas be found in paying quantities, to proceed with reasonable diligence in drilling sufficient number of wells to reasonably develop the premises;
>
> 4. a covenant to protect the land from drainage through wells on adjoining lands, by drilling offset wells; and
>
> 5. a covenant to market the produce of producing wells. *Ware*, 269 Ark. at 321, 602 S.W.2d at 623-624, (*citing* Summers, *The Law of Oil & Gas*, Chpt. 13, § 395 (Vol.2, 1959). *See also Klein*, 980 F.2d at 521.

In addition to the language of the lease and the covenants implied by the courts, Arkansas statutes dictate certain rights and obligations relative to the interests of royalty owners:

> It shall be the duty of both the lessee, or his assignee, and any pipeline company, corporation or individual contracting for the purchase of oil or gas under any oil, gas, or mineral lease to protect the royalty of the lessor's interest by paying to the lessor or his assignees the same price including premiums, steaming charges, and bonuses of whatsoever name for royalty oil or gas that is paid the operator or lessee under the lease for the working interest thereunder.

Ark. Code Ann. § 15-74-705 (1987).

Judge Arnold conducted a seven-day trial on plaintiffs' implied covenant claim as against the Arkla defendants. Accordingly, this court had to first determine whether the record had been fully and fairly developed on the implied covenant claim against the Arkla defendants and, if not, to take such additional proof as would be appropriate.

After carefully reviewing the record made on the implied covenant claim, the court determined that Judge Arnold and the parties had intended to try, and had fully tried, this claim during the first proceedings. The court therefore concluded that the decision on this claim should be based solely on the record previously developed before Judge Arnold and so declined to permit the parties to supplement that record or to present any further evidence with respect to that claim. As far as reasonably possible, the court has attempted to limit its consideration of the proof on the implied covenant claim to that contained in the said record.

Since plaintiffs' unjust enrichment claim against Jones/McCoy was dismissed by Judge Arnold prior to trial, no evidence with respect to it had been taken prior to the proceedings conducted by the author of this opinion. It is, therefore, important to further state that in considering the said claim against Jones/McCoy, this court did not consider any of the proof developed during Judge Arnold's hearing *unless* that proof was again presented during the five day hearing conducted by the court on the said unjust enrichment claim.

While the court is treating and disposing of both plaintiffs' implied covenant claim against the Arkla defendants and their unjust enrichment claim against Jones/McCoy in one opinion, it must nevertheless be kept in mind that the claims are being decided upon the two different proofs. Therefore, in its discussion of the claims, it will unfortunately be necessary for the court to repeat certain features of the different proofs which are substantially similar and which apply to both claims.

THE UNJUST ENRICHMENT CLAIM

Findings of Fact

1. Plaintiffs' leases were made over a period of years to various parties — not just to the Arkla defendants — and in succeeding years, the leases were, from time to time, assigned by the lessees until such time as they all came to be owned by Arkla. Plaintiffs would not have had anything to complain about because their leases were transferred, by mesne conveyances, to Arkla prior to 1982. To the contrary, these transfers would seem to have been in the best interest of the plaintiffs since Arkla was and is a major gas production company and it would seem logical that the plaintiffs would have preferred to have their leases in the hands of a large producer which would be more likely to have adequate funds for exploration, production and marketing.

2. Prior to 1982, Arkla had done some exploration and drilling on the leases in question and there had been some production. Plaintiffs would have had no reasonable complaint about that since it was precisely what was contemplated when the leases were made in the beginning — that there would be some exploration, drilling and hopefully some production of gas which would give rise to royalty payments to plaintiffs.

3. In 1982, when Arkla sold the leases in question to Arkoma, plaintiffs would seem to have had no reason to object to such a transaction because it promised to result in exploration of their leased lands whereby they would find out whether they had extensive gas reserves and, therefore, whether they could expect to receive considerable royalties in the future. Specifically, the $15,000,000 sale would seem to have been no problem for the royalty owners because there were no take-or-pay claims involved in the sale or anything of that nature which could conceivably have given rise to a claim on behalf of the royalty owners that they were entitled to something by reason of that sale.

4. In 1983, when Arkla and Arkoma entered into GPC 5239, it does not appear the royalty owners objected, or that they would have had any reason to object to the terms of GPC 5239 since if gave them a reasonable expectancy of receiving one-eighth royalty on a high, fixed price at no risk or cost to them. Therefore, at this point, the plaintiff royalty owners clearly had no objection to either the sale of the leases from Arkla to Arkoma or the formation of GPC 5239 since both events boded well for the future income prospects of the plaintiffs by way of their one-eighth royalty which they would be entitled to receive under their lease agreements.

5. Neither the sale of the leases from Arkla to Arkoma nor the institution of GPC 5239 in any way changed the terms and provisions of the mineral leases under which

the plaintiffs must claim if, indeed, they have any claim under the circumstances.

6. During the period of approximately 1983 into 1985, Arkoma's drilling program achieved over a 90 percent success ratio against an industry average of only 50 percent. This fact surely was not objectionable to the plaintiffs and, indeed, probably wrought joy to their hearts. Additionally, as and when Arkoma brought in the gas wells, royalties were paid to the plaintiffs in accordance with the favorable terms of GPC 5239. Again, to state the obvious, plaintiffs had no complaint or objection to these events and no doubt were quite pleased with the initiative, energy and success of Arkoma under the direction of Jones/McCoy, who were then its principal stockholders and its officers and directors.

7. Commencing in 1985 and 1986, however, because of artificial pricing and other provisions of the NGPA, as well as other events beyond the control of Arkla, Arkoma, Jones/McCoy or the plaintiffs, natural gas prices declined and the natural gas market was glutted. As a result, Arkla reduced the amount of gas it was taking and eventually refused to honor GPC 5239 with respect to either the take provisions or the take-or-pay provisions. Now, one could reasonably suspect that these actions by Arkla would have been bothersome to the plaintiffs because they were not getting the royalties they would expect to get because of the gas which had been discovered and made ready for marketing by Arkoma and which, under GPC 5239, would produce high royalties because of the favorable price — which price now stood out clearly in view of the market decline. However, one might also reasonably (and correctly) conclude that any displeasure or anger the plaintiffs might have had as a result of this turn of events, would have to be directed at Arkla and not at Arkoma or Jones/McCoy. After all, it was Arkla who was refusing to take the gas or, failing to take it, also failing to pay for

it. Up to this point, Arkoma had performed admirably for the plaintiffs, having risked huge sums of money and having achieved a remarkable success rate. As of that time, it seems apparent that Arkoma (then owned and operated by Jones/McCoy) had done everything that a reasonable plaintiff royalty owner could expect a lessee to do.

8. As a result of Arkla's action of not taking or paying for gas as required by GPC 5239, Arkoma responded by pressing Arkla to comply with its obligations under GPC 5239. Arkoma insisted that Arkla should keep its part of the bargain since Arkoma had risked millions of dollars to carry out its end of the bargain and should now be entitled to the fruits of its labors and the premium for the risks it had taken. The plaintiffs certainly would not have taken offense at this posture of Arkoma on the matter since, if it were successfully maintained, the royalty owners could expect to continue to receive a one-eighth royalty on a favorable gas contact price notwithstanding the poor gas market at the time. Thus, Arkoma's action of trying to force Arkla to comply with the contract certainly was not bothersome or troublesome to plaintiffs since its success would mean more money in their pockets, as royalty owners, and its failure would mean less money in their pockets. Again, as before, if the plaintiffs were upset with anyone or had a right to be upset with anyone at that point, it would be Arkla and not Arkoma or Jones/McCoy.

9. When Arkoma tried to negotiate its take-or-pay claims with Arkla, it is probably accurate to think that the plaintiffs would have watched these negotiations with interest if they had known about them. However, as long as Arkoma was vigorously trying to enforce its rights under GPC 5239, it would appear the plaintiffs really would have had no complaint since, it is assumed, they would be justified in believing that whatever would be good for Arkoma — which had invested a lot of

money and was entitled to seven-eighths of the monies received from the sale of gas — would also be good for them, the royalty owners, who had invested nothing but would nevertheless be entitled to one-eighth of the sale price of any gas sold. So, as before, if the plaintiffs had a complaint down to this point, it would have to be against Arkla and not against Arkoma or Jones/McCoy.

10. The take-or-pay claim arose under GPC 5239 and belonged to Arkoma as one of the parties thereto. Neither Jones nor McCoy had any personal interest in any such take-or-pay claim since they were not parties to the said GPC.

11. Up to 1986, Arkoma was apparently doing everything it could to market its gas under GPC 5239 in compliance with the implied covenant to market gas if prudent and commercially reasonable, but could not do so because Arkla refused to either take or pay.

12. In late 1986, and after extensive negotiations which made it apparent to Arkla that Jones/McCoy, as principals, directors and stockholders of Arkoma, were not going to "be reasonable" (at least as far as Arkla was concerned), the notion occurred to the folks at Arkla that perhaps Arkla should consider simply buying Arkoma — and with it, GPC 5239. Arkla approached Jones/McCoy about the possible purchase of Arkoma and a new round of negotiations began.

In a comparatively short time, the new negotiations bore fruit. On December 31, 1986, Arkla (acting through a wholly owned subsidiary, Arkla Exploration) purchased Arkoma — lock, stock and barrel.

13. Arkoma was purchased by Arkla *completely intact* in that none of plaintiffs' leases were assigned, transferred, amended or otherwise disturbed but, instead, remained exactly the same as they were before Arkoma was sold.

14. GPC 5239 likewise was not amended, transferred, assigned or otherwise disturbed by reason of the sale of Arkoma, but, rather, remained exactly the same as it had been before the sale.

15. Whatever take-or-pay claim which Arkoma may have had against Arkla prior to the time Arkoma was sold to Arkla, also remained undisturbed and unchanged. There is no evidence that the take-or-pay claim, whatever it might have been and whatever it might have been worth, was in any way changed by the sale of Arkoma to Arkla. Moreover, there was no disturbance to the other provisions of GPC 5239 which were favorable to Arkoma (and presumably favorable to the royalty owners) such as the 75% take provision; the favorable pricing provision; the five-state dedication provision; and the unilateral negotiation provision.

16. Notwithstanding the fact that nothing relative to the mineral leases, to GPC 5239 or to the take-or-pay claim changed by reason of the sale of Arkoma from Jones/McCoy to Arkla, plaintiffs nevertheless became quite agitated toward Jones/McCoy because of such sale. They discovered, in due course, that GPC 5239 had been amended in February 1987, (with retroactive application to January 1, 1986) so as to eliminate its favorable provisions for New Arkoma — the lessee under plaintiffs' leases. Although the contract was not amended, renegotiated or otherwise changed by Arkoma *before* Jones/McCoy sold Arkoma to Arkla, the plaintiffs nevertheless contend that Jones/McCoy settled the "take-or-pay claim" against Arkla by selling the company to Arkla. Plaintiffs ignore the fact that GPC 5239 was amended only *after* Arkla, acting by and through its wholly owned subsidiary, Arkla Exploration, became the owner of Arkoma and that, in fact, Jones/McCoy had nothing to do with the amendment of the contract.

17. If it could be shown that prior to the sale or in connection with the sale, the mineral leases under which

plaintiffs' rights must arise were changed, diminished or somehow compromised by the actions of Jones/McCoy, then perhaps plaintiffs might have a claim against Jones/McCoy for unjust enrichment. However, the evidence shows nothing untoward or improper was done by Jones/McCoy prior to the sale which in any way harmed whatever rights plaintiffs had under their mineral lease agreements with Arkoma. Moreover, although plaintiffs were not parties to GPC 5239 and the Court of Appeals has determined that they were not third-party beneficiaries thereto, even if plaintiffs could show that they somehow had some rights under GPC 5239, there is absolutely no evidence that Jones/McCoy did anything at all to impair, damage or otherwise injure those rights under GPC 5239 either before or after the sale.

18. Arkoma received nothing on any take-or-pay claim prior to the time it was sold by Jones/McCoy to Arkla Exploration.

19. Jones/McCoy, either as officers, directors and stockholders of Arkoma or individually, received nothing on any take-or-pay claim prior to the time Arkoma was sold to Arkla Exploration.

20. Prior to the sale of Arkoma, its take-or-pay claim against Arkla was not admitted or otherwise recognized but, rather, was strongly disputed by Arkla.

21. Arkoma, when owned by Jones/McCoy, staunchly advanced the take-or-pay claim and refused to settle it with Arkla.

Conclusions of Law

1. After the appeal of this Court's earlier grant of summary judgment in favor of Jones and McCoy, plaintiffs' only claim remaining against these defendants is for "unjust enrichment" and is based on the theory that Jones and McCoy settled a take-or-pay claim against the

Arkla defendants which was allegedly worth several millions of dollars.

2. Plaintiffs' unjust enrichment claim, based on alleged settlement by Jones/McCoy of a valuable take-or-pay claim, never came to trial before Judge Arnold — it was dismissed before trial on motion. Accordingly, there was no direct proof in the previous record on the question of whether Jones/McCoy had, in fact, settled a take-or-pay claim. It was rather, for this court on remand to hear the proof and determine what the facts are with regard to that issue. It is therefore unfortunate, in this court's view, that both the majority and concurring opinions in *Klein v. Jones assume* that the sale of Arkoma from Jones/McCoy to Arkla amounted to a settlement of a take-or-pay claim existing between the parties.[6] With respect, it is noted that the facts found by this court after a five day trial do not support that assumption.

The take-or-pay claim was not "settled" until *after* the sale and then by the amendment of GPC 5239 by New Arkoma and Arkla. What happened, in fact, is that Jones/McCoy *sold* whatever take-or-pay claim which may have existed when they sold Arkoma. Then, when Arkoma became New Arkoma and was thus owned and controlled by Arkla Exploration, a subsidiary of Arkla, GPC 5239 was amended to eliminate the take-or-pay claim. Arkla obviously bought Arkoma in order to do precisely that, but the fact remains — "that" (being the

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[6] *e.g.*: "The difference in the fair market value of the reserves and the amount paid to Jones and McCoy represented the value *paid to Jones and McCoy to settle Arkla's take or pay dispute* under GPC 5239 . . ." (emphasis added) *Klein*, 980 F.2d at 525, (majority opinion).

"I add these comments relating to the right of the lessors to share in the *take-or-pay settlement proceeds which Jones and McCoy received.*" (emphasis added) *Klein*, 980 F.2d at 533, (concurring opinion).

settlement of the take-or-pay claim) was *not* accomplished solely by the sale of Arkoma, for whatever price. Something more had to happen, and that something more was the amendment of GPC 5239. The changes accomplished by the said amendment were those changes to which Jones/McCoy had steadfastly refused to allow Arkoma to agree while they owned and controlled it. Thus, Jones/McCoy had nothing to do with the "settlement of the take-or-pay claim" except to make it possible for it to happen by selling Arkoma to Arkla. No authority has been cited to the effect that such sale by Jones/McCoy, featuring such a possibility, was either illegal or improper.

There obviously was a take-or-pay *claim* prior to the December 31, 1986 sale of Arkoma to Arkla. This claim remained undisturbed after the sale and up until February of 1987. Whether it was viable or would have stood up if litigated will probably never be known since it was not litigated. Thus, one may only speculate as to how much money it would have cost Arkoma or New Arkoma to litigate the claim; how much time it would have taken to litigate it; and what would be the value of any not recovery if success had been obtained. It seems clear that the take-or-pay claim was "eliminated" by the amendment of GPC 5239 in February of 1987. From the proof, it appears that the take-or-pay claim was not *settled*, it was simply given up by New Arkoma.

3. Plaintiffs had no legal interest in or ownership of Arkoma. At the time immediately prior to the sale of Arkoma to Arkla Exploration, only Jones and McCoy had legal interests in and ownership of Arkoma.

4. Plaintiffs' claims arise from and depend upon their leases. *See Klein*, 980 F.2d at 526. The court believes it obvious that the obligations of a corporate lessee under an oil and gas lease can be asserted by a lessor only against the said corporate lessee and not against former owners and/or stockholders absent some compelling reason to pierce the corporate veil. It will be recalled

that plaintiffs' leases had been assigned first to Arkla (prior to 1982) and then to Arkoma (1983). Paragraph 9 of the leases says, *inter alia*, that if a lease is assigned, the lessor ". . . shall look solely to the assignee for the performance of this lease. . . ."

5. The doctrine of unjust enrichment is to the effect that a contract will be implied as a matter of law —as a "quasi-contract" or a "constructive contract"— where it appears that otherwise one person might be free to unjustly enrich himself at the expense of another. Such an implied contract does not rest upon the assent of the parties, either express or implied. It is strictly a legal fiction created by the law to do justice. *Dews v. Halliburton Industries, Inc.*, 288 Ark. 532,536, 708 S.W.2d 67, 69 (1986) *citing Dunn v. Phoenix Village, Inc.*, 213 F. Supp. 936, 951 (W.D.Ark. 1963) and Brill, *Arkansas Law of Damages*, § 33-2 (2d ed. 1990). To find unjust enrichment, a party must have received something of value, to which he was not entitled and which he must restore. *Dews*, 288 Ark. at 536-708 S.W.2d at 69 (*citing* Brill, *supra*; *Frigillana v. Frigillana*, 266 Ark. 296, 307, 584 S.W.2d 30, 35 (1979)). One who is free from fault cannot be held to be unjustly enriched merely because he has chosen to exercise a legal or contract right. *Whitley v. Irwin*, 250 Ark. 543, 550, 465 S.W.2d 906, 910 (1971) (*citing Worthen Bank & Trust Co. v. Franklin Life Ins. Co.*, 260 F. Supp 1, 6 (E.D. Ark. 1966), *aff'd* 370 F.2d 97 (8th Cir. 1966); *Pelser v. Gingold*, 214 Minn. 281, 291, 8 N.W.2d 36 (1943). One is not unjustly enriched by receipt of that to which he is legally entitled. *Whitley*, 250 Ark. at 550, 465 S.W.2d at 910 (*citing American University v. Forbes*, 88 N.H. 17, 183 A. 860 (1936)).

> "As appropriately stated by District Judge Henley in the *Worthen* case, 'Parties to business transactions are required to act justly and honestly, but they are not required to act unselfishly or altruistically.' A moral duty does not meet the demands of equity in this regard, in the absence of some specific legal

> principle or situation which equity has established or recognized bringing a case within the scope of the doctrine. *American University v. Forbes*, supra. *Anderson v., Anderson*, 155 Kan. 69, 123 P. 2d 315 (1942). No recovery of money received can be based upon unjust enrichment when the recipient can show a legal or equitable ground for keeping it. *Beauregard v. Orleans Trust Co.*, 108 Vt. 42, 182 A. 182 (1936)."

Whitley, 465 S.W.2d at 910-911; 250 Ark. at 550-551.

Had Jones and McCoy declined Arkla's offer to buy Arkoma and, instead, pressed forward on Arkoma's take-or-pay claim, *perhaps* such actions would have been perceived to be unselfish and/or altruistic — certainly such would have been the perception if such actions would have been taken principally in the interests of the plaintiff royalty owners and at the possible expense of Jones and McCoy. However, such actions, under the circumstances, almost certainly would have amounted to poor and unprofitable business conduct on the parts of Jones and McCoy. There were no assurances as to how long it might take to litigate the take-or-pay claim; how much it might cost to litigate it; or what prospects there were for success with such litigation. Against those uncertainties there was a concrete lucrative offer for the purchase of the corporation and its assets from a responsible and substantial company, concerning which there were assurances as to how much would be paid and when it would be received.

There is no proof that Jones and McCoy did not act justly and honestly in the matter and, as stated by Judge Henley, they were not required to act unselfishly or altruistically.

6. A corporation, like Arkoma or New Arkoma, is an entity separate from its stockholders. *Shipp v. Bell & Ross Enterprises, Inc.*, 256 Ark. 89, 97, 505 S.W.2d 509,

515 (1974); *Banks v. Jones*, 239 Ark. 396, 390 S.W.2d 108 (1965). Generally a "corporation", while itself an association of individuals, is also something more. It is, in contemplation of law, an artificial being or person created by law having a legal entity entirely separate and distinct from the individuals who compose it, with the capacity of continuous existence of succession notwithstanding changes in its membership, and having also the capacity, as such legal entity and artificial person in the law, of taking, holding and conveying property, entering into contracts, suing and being sued, and exercising such other powers and privileges as may be conferred on it by the law of its creation. *McCarroll v. Ozarks Rural Elec. Co-Op. Corp.*, 201 Ark. 329, 332-333, 146 S.W.2d 693 (1940). In special circumstances, when the corporate form has been illegally abused, the court will disregard the corporate facade but the rule of piercing the fiction of a corporate entity should be applied with great caution. *Banks*, 239 Ark. at 399, 390 S.W.2d at 110. The corporate structure is to be disregarded only when it is illegally abused to the injury of a third person. *Arkla Chemical Corp. v. Palmer*, 250 Ark. 405, 414, 465 S.W.2d 335, 340 (1971).

7. It follows, from the court's findings of fact and the foregoing authorities, that the take-or-pay claim against the Arkla defendants belonged to Arkoma and not to Jones and McCoy and, thus, only Arkoma could collect it, settle it or abandon it.

Upon the sale of Arkoma, Jones and McCoy were legally entitled to receive all they did receive from such sale. They had the legal right to sell their interests in Arkoma (including the take-or-pay claim) and cannot be said to have been unjustly enriched because they chose to exercise that legal right. *See Whitley*, 250 Ark. at 550; 465 S.W.2d at 910.

There is no evidence that Jones and McCoy plundered the Arkoma corporation prior to selling it to Arkla Explo-

ration. There is no evidence that the corporate form was illegally abused by Jones and McCoy to the injury of plaintiffs or any other third person. It follows that there is certainly no evidence to warrant piercing the corporate veil and holding that, somehow, the sale of their ownership interests in Arkoma by Jones and McCoy amounted to an illegal act which injured plaintiffs.

8. The court therefore concludes that plaintiffs' claims against Jones and McCoy, based upon the theory of unjust enrichment, are not supported by a preponderance of the evidence and should be denied and dismissed.

9. Inasmuch as plaintiffs have made no claim against New Arkoma or Arkla for alleged unjust enrichment [7], there is little utility in pursuing further analysis of the abandonment of the take-or-pay claim by New Arkoma except as the same may be relevant in connection with the claim plaintiffs have made against Arkla (and presumably against New Arkoma which is owned by Arkla's subsidiary, Arkla Exploration) — alleged breach of the implied covenant to market gas.

THE IMPLIED COVENANT TO MARKET

Findings of Fact

The court now turns to a consideration of the plaintiffs' implied covenant claim against the Arkla defendants.

As noted by the Court of Appeals, plaintiffs' rights, if any, with respect to this claim must flow from the leases. Thus, the starting point must be an analysis of the leases relative to this claim.

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[7] The court does not here imply that plaintiffs would have necessarily been successful if they had made such a claim against New Arkoma or Arkla.

1. When the leases were first made, the lessee was then under no absolute duty to drill for gas on the leasehold. Under the terms of the lease, the lessee could simply pay certain "delay rentals" to keep the lease in effect during the primary term even without some drilling activity. (*See* paragraph 4 of the leases).

2. The proof indicates that some drilling was undertaken by the lessees under the leases (either by Arkla, itself, or by its predecessors in interest) before the leases in question were transferred to Arkoma. It does not appear that, prior to the transfer of these leases, plaintiffs would have had any reason to content that Arkla or its predecessors, as lessees under the leases, had in any way breached any express covenant contained in the mineral lease or any implied covenant which obligated them by law.

3. When the leases in question were assigned by Arkla to Arkoma in connection with the sale which occurred in 1982, whatever obligations then existing on the part of the lessee under the leases in question, were passed along to Arkoma as the new lessee.

4. As noted elsewhere in this opinion, Arkoma entered into GPC 5239 with Arkla as an integral feature of its purchase of the leases. That purchase had included, it will be remembered, an obligation on the part of Arkoma to spend $30,000,000 in exploration costs within a four-year period. Apparently, for the purpose of insuring that it would have a stable market for any gas that might be found as a result of its risky expenditure of some $30,000,000 in exploration costs, Arkoma negotiated GPC 5239 with Arkla and then included plaintiffs' leases under that contract or, perhaps more precisely, arranged to market with Arkla any gas that might be produced on the leaseholds covered by plaintiffs' leases as a result of the drilling effort. There is no reason to believe that any express or implied covenant on the part of the lessee under the mineral leases had been or was being violated

by these activities of either Arkla or Arkoma. The results of that sale and transfer from Arkla to Arkoma in 1982 redounded to the benefit of the plaintiffs and promised to fulfill obvious purposes of the leases in question — to explore for, hopefully find and then produce and sell gas off the leaseholds covered by the leases with the result that plaintiffs would receive a one-eighth royalty on such gas that was produced and sold.

5. When Arkoma achieved better than 90 percent success in drilling for gas (against an industry average of something like 50 percent), the gas began to be marketed under GPC 5239 with the result that plaintiffs were getting royalties based upon the favorable prices of GPC 5239. Here again, there is certainly no reason to think that this turn of events would amount to a violation of either express or implied covenants under the leases in question.

6. When Arkla began to refuse to take (and failing to take also refused to pay for) gas that had been discovered by Arkoma, it would seem obvious that this action would be of concern to the plaintiffs. At that point, Arkoma, as the current lessee, had the obligation to perform all the covenants, express or implied, which flowed in favor of the plaintiffs under the leases in question. Arkla had no such responsibility to the plaintiffs and, in fact, Arkla was the culprit whose actions were interfering with the marketing of the gas. Up until the sale of Arkoma to Arkla on December 31, 1986, it does not appear to the court that Arkoma — the entity having the implied obligation to market gas — had done anything but strive mightily to do precisely that. The proof indicates that Arkoma had made every effort, short of litigation, to force Arkla to take the gas under GPC 5239 and thereby fulfill Arkoma's marketing obligation to the plaintiffs. Those efforts had been unsuccessful and Arkoma was faced with the prospect of filing a lawsuit against a defendant with substantial assets and

resources, which could take years to conclude and which would involve the expenditure of large sums of money.

It cannot be reasonably said that Arkoma's actions up to December 31, 1986, amounted to a violation of any express or implied covenant under the mineral leases. While it might be said that Arkla's actions down to that point were injurious to the plaintiffs (as well as Arkoma), Arkla did not then *have* the implied obligation to market gas on behalf of the plaintiffs but was, in fact, an adverse party with respect to that obligation as to both Arkoma and plaintiffs. The court notes parenthetically that under the Arkansas statute quoted above, Arkla had a continuing duty to pay to the plaintiff royalty owners the same price it was paying to Arkoma — however, that was the rub — *Arkla wasn't paying any price to anyone.*

7. When Arkoma was sold — intact and complete — to Arkla by the said contractual arrangements which concluded December 31, 1986, the situation with respect to the implied covenant to market gas did not change in the least. That obligation still rested with Arkoma as the lessee under plaintiffs' leases and was not altered or changed by the change in ownership of Arkoma. Accordingly, down to that point, Arkoma had not done anything to breach any covenant, express or implied, flowing to plaintiffs with respect to the mineral leases.

8. After Arkoma was sold to Arkla, however, the new owners and controllers of New Arkoma saw fit to accept a longstanding offer by Arkla to amend GPC 5239 in such a way as to reduce the prices and thereby get the gas flowing to market. It was Arkla's position — and had been its position for several months — that the gas should flow in accordance with the market price which was available and that GPC 5239 would have to be amended before it would be reasonable and prudent to try to market gas under it.

9. There is no evidence that plaintiffs could have expected their gas to be marketed at a price similar to that available under GPC 5239 had they tried to market it anywhere else. The evidence indicates that the gas prices at the time were in the neighborhood of $1.50 per mcf and that was all that was available. After the contract was amended in February of 1987, the price which was available for the plaintiffs' gas under their leases was $2.20 per mcf which was above the then available market price.

10. It is clear that in 1986, gas prices had "gone south" and that the market price available for gas was in the neighborhood of $1.50 per mcf. Looking at the mineral lease provisions, it would seem that under these circumstances, the lessee would have no obligation to market gas at a loss. The lease seems to indicate that if market conditions make it unreasonable or imprudent to market gas, the lessee doesn't have to market gas at that time but can simply pay a royalty of $100 per well per year until such time as the gas can be profitably produced and marketed. (*See* paragraph 3(b) of the typical lease). Thus, if there had been no GPC 5239 contract with its favorable price, it seems clear plaintiffs probably would have been argued that New Arkoma should have been out marketing gas when the market price was so low it would have been financially ruinous to bring the gas to the surface and sell it. It therefore appears the main reason plaintiffs are complaining is the fact that GPC 5239 — with its favorable gas prices and take or pay feature — *was* in existence and yet none of their gas was being taken and sold under it nor were they receiving royalties on any required payment due because the gas was not being taken and sold.

11. If Arkla had not ceased taking gas under GPC 5239 and either Arkoma or New Arkoma had failed to continue supplying it, then there would be a basis for holding that such failure(s) amounted to a violation of either

express or implied covenants to market gas. These, however, were not the facts.

12. Once Arkla refused to take and, failing to take, also refused to pay, Arkoma was faced with alternatives of either compromising their take-or-pay claim or filing suits on GPC 5239 to try to enforce the same.

13. Arkoma, while owned by Jones/McCoy, refused to compromise the take-or-pay claim.

14. Arkoma, while owned by Jones/McCoy, did not file suit to enforce the take-or-pay claim under GPC 5239.

15. New Arkoma and Arkla (Arkla Exploration) agreed to amend GPC 5239 in February of 1987 (and made the amendment effective as of January 1, 1987), and such amendment terminated the take-or-pay claim.

16. When New Arkoma agreed to amend GPC 5239, and in so doing gave up certain rights, it was giving up only *contract rights* — the most important of which were staunchly disputed by the other party to the contract — Arkla. Plaintiffs were not third party beneficiaries of GPC 5239, but, at most, were only incidental beneficiaries thereof. *Klein*, 980 F.2d at 527. Accordingly, they had and have no standing to complain if New Arkoma chose to give up rights under the contract in question. Nevertheless, it is interesting to see just what rights New Arkoma did give up when it agreed to an amendment of GPC 5239:

(a) The take-or-pay claim.

The proof at trial (principally the testimony of McCoy) indicated that Arkoma's initial demand of $36 Million was inflated and included claims no longer owned by Arkoma. McCoy admitted having little faith in the vitality of the claim and expressed surprise that Arkla did not immediately pick it apart by picking up on rather obvious defects. The proof further showed that Arkla was

adamantly opposed to the claim and was not going to pay it unless forced to do so by litigation. Had the claim been litigated, there would have been a continuing erosion of the plaintiffs' gas reserves under other contracts while the matter made its way through the courts. To have a chance at being successful in the litigation, New Arkoma would have had to be willing to spend large sums of money for lawyers and litigation expenses — all while not having a revenue stream which was needed to defray accrued obligations and ongoing expenses.

If New Arkoma could have settled the take-or-pay claim for any amount, gas would probably have been identified to the contract and taken at a later date. By simply amending the contract price provision from $3.83/mcf, to $2.20/mcf, New Arkoma accomplished essentially the same thing except that neither it nor its royalty owners (the plaintiffs) would get their money immediately — they would have to wait for it as and when the gas was actually brought to the surface and marketed. It therefore follows that with respect to the take-or-pay claim, New Arkoma gave up:

(1) the "right" to litigate with Arkla to see if it could make the contract price and the take-or-pay provision stand up and thereby collect some price between the $3.83/mcf called for therein and the $2.20/mcf which Arkla was willing to pay for gas to be taken in the future; and

(2) the immediate enjoyment, if the litigation were to be successful, of whatever amount a court might award — less, of course, expenses of litigation and attorneys' fees.

(b) The higher gas prices

The undisputed proof is that Arkla agreed to pay, and Arkoma insisted on getting paid, the prices set forth in

GPC 5239 principally because if Arkoma was going to spend $30 million in a risky four year drilling program, it had to insure that, if the operations were successful, it would have a reliable market and price for the gas which hopefully would not only allow Arkoma to recover the exploration costs, but which would also allow Arkoma (and its royalty owners) to make money. Thus, Arkoma (and its then owners and investors, Jones/McCoy) had good and sufficient reasons to bargain for and insist upon receiving a certain price for gas, which price could not be lowered even if the market retreated (which it unexpectedly did) but which could be raised if the price went up [i.e. the unilateral negotiation provision which would enable Arkoma (but not Arkla) to negotiate the price up or, failing agreement by Arkla, to abandon GPC 5239 and sell the gas elsewhere at a better price].

Plaintiffs had risked nothing and were neither parties to nor third party beneficiaries of GPC 5239. If Arkoma and Arkla had not, for the reasons mentioned, chosen to enter into GPC 5239 with all its favorable aspects, plaintiffs would still have been entitled to get, as royalty, one-eighth of the market price, at the mouth of the well, of any gas produced and sold. After GPC 5239 came into being, plaintiffs benefited from Arkoma's aggressive efforts as well as from the favorable gas prices required by the contract. As has been said by both the Court of Appeals and by this court, plaintiffs were incidental beneficiaries with respect to GPC 5239. Thus, these benefits incidentally acquired by plaintiffs when GPC 5239 came into being were in like manner incidentally lost when New Arkoma and Arkla, for prudent reasons, amended GPC 5239.

Arkoma had lots of gas and a favorable contract but it had no way to actually market that gas and capitalize on the contract short of a lawsuit. What stood in the way of the marketing was, of course, Arkoma's insistence (at

the behest of Jones/McCoy) that the favorable provisions of GPC 5239 be honored and Arkla's insistence that it would not comply with same. Once Jones/McCoy got out of the picture — by the sale of Arkoma — the situation changed. Arkla had compensated Jones/McCoy for the risk they had taken and for the premium they deserved for their success, and the reasons for maintaining the high gas price and the take-or-pay provisions (as well as the other favorable provisions) of GPC 5239 no longer existed. Accordingly, the GPC 5239 gas price could be amended to bring it into line with market conditions and the take-or-pay provision could be eliminated since the reserves were not essentially known and the cost of discovering them had been paid.

17. In *Klein*, the Court of Appeals said:

> In *Amoco Production Co. v. Ware*, 269 Ark. 313, 602 S.W.2d 620 (1980), the Arkansas Supreme Court carefully reviewed the relationship of a developer to a lessor among a group of lessors and recited the five implied warranties arising out of the lessor-lessee relationship and it found no implied breach of fiduciary duty by lessee. Instead, it defined the duty owed each lessor, and to the lessors as a group, to act for the mutual advantage of both. It held that the lessee must act in a reasonable and prudent manner, using reasonable judgment, and not act arbitrarily.
>
> In this case the take-or-pay elements in the developers contracts with the pipeline/marketer were, because of Federal Energy Regulatory Commission intervention, literally bankrupting the pipeline, and those facts must be considered in evaluating the reasonableness of defendants' actions. We find it reasonable for the defendants to make some effort to liquidate the take-or-pay obligations of AEC.

Id., 980 F.2d at 526.

The Court of Appeals further observed that the ". . . test of compliance with an implied covenant is that of a reasonable developer." *Id.* at 532.

It therefore appears that both the appellate court and this court are in agreement that it was reasonable for the Arkla defendants to make some effort to liquidate or eliminate the take-or-pay obligations of Arkla under GPC 5239. The action taken was, as mentioned above, to amend GPC 5239 by formal amendments effective on January 1, 1987. The amendments provided (to the extent that such actions had not previously been taken):

(1) All take-or-pay claims of New Arkoma as against Arkla were released;

(2) The price of gas taken under the contract was established at the level of $2.20 per mcf for gas taken under the contract;

(3) Future take-or-pay requirements were eliminated and New Arkoma was afforded a release of gas not required by the pipeline so that New Arkoma could market gas on the "spot market." (*See* Plaintiffs' Trial Exhibits 4 and 5 and Arkla Trial Exhibit 201).

In evaluating the reasonableness and prudence of this particular effort to eliminate the "problem", the court notes the following:

(a) Looking at the matter from the perspective of the Arkla defendants, it seems obvious that, in their view, the three agreements entered into on December 31, 1986 (concerning the purchase of Arkoma from Jones/McCoy), and the "reformation" of GPC 5239 with New Arkoma were part and parcel of one overall transaction. A purpose of the Arkoma acquisition transaction was to get into a position to accomplish the reformation of GPC 5239 and all other gas contracts under which Arkoma sold gas to Arkla Energy. (*See* Warren testimony, Tr. Vol. I, pp. 105-10).

(b) It will be remembered that Arkla Exploration's purchase of Arkoma took place on December 31, 1986, and complete ownership of Arkoma (thus making it thereafter, New Arkoma) was transferred from Jones/McCoy to Arkla Exploration on that date. Further, the parties agreed at that time to a procedure, set forth in the Asset Purchase Agreement, to re-evaluate certain recently-drilled wells ("Category I Wells") after an additional period of production and to test, drill, and evaluate new wells ("Category II Wells") in order to adjust the payment for Arkoma's proved undeveloped reserves. Jones/McCoy agreed to fund New Arkoma's share of drilling costs for the Category II wells, so that the actual amount Jones/McCoy would receive for "Category II" reserves would be reduced by those drilling costs. (*See* Mitchell testimony, Tr. Vol. II, pp. 125-26; Arkla Trial Exhibit 242). Jones/McCoy directed and funded the drilling of Category Ii wells beginning in 1987, and, in connection with many of these wells, New Arkoma obtained additional working interests and exercised its rights under the Asset Purchase Agreement to require Jones/McCoy to fund New Arkoma's share of drilling costs attributable to these additional interests. These additional working interests were owned by other producers or individuals, and the gas attributable to those interests was not at any time dedicated to GPC 5239. In addition, New Arkoma drilled many of the Category Ii wells under "non-consent" provisions of the joint operating agreements to which New Arkoma and other working interest owners were parties. Under these non-consent provisions, any working interest owner who did not consent to the drilling of a new well was not required to incur any of the costs of drilling. The non-consenting party, however, did not receive his share of revenue from that well until the operator (New Arkoma) recovered anywhere from one and one-half to four times the drilling costs, depending on the arrangement. As a result of obtaining additional interest and by drilling

"non-consent," New Arkoma's net revenue interest in the Category II wells was increased substantially for purposes of the re-evaluation of Arkoma's proved undeveloped reserves. (*See* Mitchell testimony, Tr. Vol. II, pp. 126-27; Arkla Trial Exhibit 243). Thus, in addition to other benefits obtained by New Arkoma and its royalty lessors from the New Arkoma marketing decision created a situation in which New Arkoma could sell produced gas (rather than being shut in and receiving only the relatively small amount of pipeline takes) so that, commencing in 1987, New Arkoma was in a position to drill additional wells. The additional drilled well produced substantial volumes of gas on which royalties were paid, and significant numbers of plaintiffs shared in said royalties (those members of the Class who were lessors in the gas production units affected). (*See* Chaney testimony, Tr. Vol. III, pp. 148-49).

(c) At all times material to this litigation, all plaintiffs who are lessors under market value or proceeds types of leases have been paid by Arkoma (and/or New Arkoma) royalties based on the actual proceeds received by Arkoma (and/or New Arkoma) from the sale of subject gas. The prices of such proceeds were equal to or greater than the market value for such gas and such payment of royalties fully satisfied Arkoma's (and/or New Arkoma's) royalty obligation to its lessors. (*See* testimonies of Terry, Tr. Vol. III, pp. 230-31; Atkinson, Tr. Vol. III, pp. 28-30; Rosene, Tr. Vol. II, pp. 244-45 and Morris, Tr. Vol. II, pp. 80-81; Exhibits 17 and 18 to Arkla Defendants' Motion for Summary Judgment).

(d) Based on the testimonies of executive officers of Arkla Pipeline Group (the purchasing pipeline), Arkoma Production Company (the producer) and independent expert witnesses, the marketing decision made by New Arkoma effective January 1, 1987, appears to have been typical of marketing decisions being made in the gas production industry by multiple producers with refer-

ence to multiple gas purchase contracts at the pertinent period of time and, in their views, was reasonable and prudent. (*See* Tr. Vol. III, pp. 7, 12, 14-18, 24-38; Tr. Vol. I, pp. 228-36, 275, 279-80; Tr. Vol. III, pp. 221, 233-39; and Tr. Vol. III, pp. 294-96).

(e) The marketing decision made by New Arkoma was the same decision made previously by Arkla Exploration in similar situations. It will be remembered that Arkla Exploration is the producing arm of Arkla and, as such, occupied a similar position to that of New Arkoma with respect to contracts with pipelines. Since Arkla Exploration owned working interests in essentially all of the subject units and was producing its interests at full volume for sale on the spot market, New Arkoma's interest was rapidly getting "out of balance" during 1986 when no gas was flowing under GPC 5239. If New Arkoma had not made the same marketing decision (as previously made by Arkla Exploration), New Arkoma and its lessors would have become even further "out of balance" with Arkla Exploration and other working interest owners. This constantly deteriorating balancing situation tended to discourage a producer such as New Arkoma (considering not only its own interests but also the interests of its royalty owners), from litigating the contract issues with its gas purchaser and was a factor indicating the prudence of agreeing to market sensitive pricing in order to be able to sell New Arkoma's full share of produced gas. (*See* Warren testimony, Tr. Vol. I, pp. 228-34, and 279).

(f) With reference to gas production from illustrative gas production units in the years 1986, 1987 and 1988, William Chaney, Vice-President of Drilling, Production and Engineering of Arkoma at the pertinent period of time, provided testimony indicating that total production of gas as well as producer and royalty revenues from production of gas all *increased* in the year 1987 (as compared to the year 1986) by reason of New Arkoma's

marketing decision. (*See* Tr. Vol. III, pp. 149-53). More importantly, there was uncontradicted testimony that if the challenged marketing decision had not been made, Arkla Exploration would have taken ratably from all wells on its system in 1987 and subsequent years. The actual take in 1987 and 1988, even at the higher prices originally provided in GPC 5239, would have produced only a very small fraction of the revenues which were actually produced under the marketing decision. (*See* Tr. Vol. III, pp. 153-58).

(g) The testimony of representatives of Arkla, New Arkoma, and independent experts, indicated that the discounted present value of the royalty revenue stream to be received by the plaintiffs from the subject gas production units has been and will continue through 1998 (the end of the term of GPC 5239) to be greater under the marketing decision which allowed New Arkoma to participate in the sale of gas on the spot market than it would have been had the subject gas purchase contracts remained unchanged. (*See* Warren testimony, Tr. Vol. I, p. 180; Atkinson testimony, Tr. Vol. III, pp. 37-39; Chaney testimony, Tr. Vol. III, p. 158; Terry testimony, Tr. Vol. III, p. 239 and Glenn testimony, Tr. Vol. III, p. 296).

The foregoing observations strongly indicate that the marketing decision made effective January 1, 1987, was good both for the lessee (New Arkoma) and the lessors (Plaintiffs) in that the present value of the cash flow resulting from the marketing decision would appear to be greater than the present value of the cash flow which would have resulted had the marketing decision not been made by New Arkoma.

18. Plaintiffs presented evidence in an attempt to show they suffered damage from the marketing decision, including, *inter alia*, the testimony of Mr. Bob Klein who is a lessor under a market value lease with reference to the E. Y. Hill #2 unit (hereinafter "Hill #2"). Mr.

Klein identified the 1986-88 total production from Hill #2 and the amount of his royalties from all working interest owners. (*See* Tr. Vol. II, pp. 13, 17). From his testimony of decreasing total royalties, the court is urged to infer damage from the marketing decision of New Arkoma.

There are, however, a couple of problems with this proof. First, the proof relates to a single well and there was no showing that the situation with reference to Hill #2, operated by Arkoma, was typical of the other wells. Further, the submitted information is for total royalties received and not just the New Arkoma share of the working interest in the well. In fact, Arkla Exploration owns a portion of the Klein lease.

By 1986, and at a time when Arkoma was refusing to renegotiate GPC 5239, Arkla Exploration had entered into a marketing agreement with Arkla Energy by which Arkla Exploration's share of the gas was released from a contract commitment so that Arkla Exploration could sell the gas on the spot market. Thus, in 1986, Arkla Exploration was selling large volumes of gas from Hill #2 while Arkoma was selling nothing because of its dispute with Arkla over GPC 5239. Accordingly, the only pertinent data concerning Hill #2 relevant to plaintiffs' contention would be that which relates to the production and royalties attributable solely to Arkoma's working interest in that unit during the three year period. That information was provided by Mr. William Chaney, Vice President of Drilling Production and Engineering of Arkoma, at Trial transcript, Vol. III, pp. 149-51:

ARKOMA'S WORKING INTEREST IN E. Y. HILL #2 UNIT

YEAR	TOTAL PRODUCTION (mcf)	TOTAL REVENUES
1986	157,000	$471,000.00
1987	327,000	479,000.00
1988	59,000	39,000.00

Hill #2 was operated by Arkoma and, in 1986 when Arkoma was still owned and controlled by Jones/McCoy,

Arkoma produced approximately 65% of its entitlement of the total production from the well, which amount obviously is above the 25% takes called for by the pipeline. (*See* Tr. Vol. III, p. 150). Even so, the marketing decision effective January 1, 1987, substantially increased the total production from New Arkoma's interest in the year 1987, and slightly increased revenues available to New Arkoma and its lessors.

Similar information was provided by Mr. Chaney with reference to the Grace Hamm #2 unit (hereinafter Hamm #2) operated by Arkla Exploration. (*See* Tr. Vol. III, pp. 151-53). With reference to Arkoma's interest in Hamm #2, the following information was provided:

ARKOMA'S INTEREST IN GRACE HAMM #2 UNIT

YEAR	TOTAL PRODUCTION (mcf)	TOTAL REVENUES
1986	34,000	$101,000.00
1987	74,000	107,000.00
1988	64,000	94,000.00

Mr. Chaney indicated that the pipeline's actual take from Hamm #2 in the year 1987 was approximately 1% of the total production and that the pipeline's take in the year 1988 was 1.7%. The effect of New Arkoma's marketing decision was to allow both the lessee and the lessors to have increased revenue over the situation which had existed in 1986. Further, the proof indicated that, if the marketing decision had not been made, Arkla Energy, in 1987 and subsequent years, would have taken ratably from all wells on its system. The actual takes in 1987 and 1988, even at the higher prices originally provided in GPC 5239, would have produced only slightly more revenue than was actually produced under the marketing decision.

Secondly, plaintiffs offered a damage calculation by Mr. Robert Rosene (Plaintiffs' Trial Exhibit 109). The Arkla defendants objected to Mr. Rosene's exhibit. (*See* Tr. Vol. II, p. 235). However, Judge Arnold allowed the exhibit into evidence with the following statement:

> Well, I'll receive it as an example of how damage calculations could be made with the proper numbers, but not for the truth of the matter asserted in the numbers that were in fact used. Subject to that explanation, it will be admitted.

The probative value of this evidence is questionable. The proper measure of damages, if it otherwise appears that plaintiffs are entitled to damages, is the difference in the royalty revenue stream had the gas purchase contracts remained unchanged as compared to the royalty revenue stream actually received. *See generally Minerva Enterprises, Inc. v. Howlett*, 308 Ark. 291, 824 S.W.2d 377 (1992).

It appears that the higher or "upper" figures in the Rosene exhibit came from one of two sources. As to *some* wells existing on December 31, 1986 (but not all wells), it appears Mr. Rosene utilized the amount of the money which Jones/McCoy directed George Mitchell to allocate to the tax partners who held an interest in the gas production units prior to all of the ownership interests being transferred to Arkoma. (*See* Tr. Vol. II, pp. 204-08). As to other wells, it appears the "upper figure" in the Rosene calculation was determined by multiplying $1.62 times the net added gas reserves determined in the "prove up" period provided for by the December 31, 1986, Agreements. (*See* Tr. Vol. II, pp. 222-24). These two sets of figures were then apparently added together to determine the "upper figure" in the Rosene calculation. (*See* Tr. Vol. II, pp. 225-27). It does not seem to the court that the Rosene "upper figure" is a correct representation of the royalty revenue stream which actually would have been received had GPC 5239 remained unchanged. There is no clue as to what relationship, if any, the beginning numbers utilized in the calculation had to prices which might actually have been received if sales of gas had been made under GPC 5239 prior to its amendment. Further, it does not appear that the calcula-

tion properly took into account the probably fact that Arkla Exploration would have taken only a small percentage of deliverability because of its unrelenting and continual insistence on the viability of its ratable take defense to the gas contract disputes.

The court is also concerned about the vitality and probative value of Mr. Rosene's "lower figure" with respect to the royalty revenue stream which the royalty owners have actually received. The lower figure, which was subtracted from Mr. Rosene's "upper figure" to determine the exhibit's statement of loss of royalty by the plaintiffs, appears to be merely an arbitrary selection of the figure of 81 cents per mcf of Arkansas reserves connected to the December 31, 1986, Agreements. (*See* Tr. Vol. II, pp. 229). The testimony of Mr. Warren, President of Arkla Exploration and New Arkoma (after December 31, 1986), reveals that the 81 cents figure was the amount at which Arkla Exploration booked the December 31, 1986 gas reserves owned by New Arkoma for accounting purposes; it was a "calculated" figure having no relationship to royalties actually received; it was a figure that was affected by the fact that the December 31, 1986 reserves reviewed by Netherland Sewell (a reserve engineering firm which regularly valued Arkla's reserves for Securities and Exchange Commission filings required of Arkla) included reserves committed to low priced gas contracts not here in issue; and that it is not even the booking figure at which the net added gas reserved were booked—those reserves were booked at $1.62 per mcf. (*See* Tr. Vol. I, pp. 214-16 and 264-270).

Even allowing, as one must, for a certain latitude and degree of imprecision which customarily attend damage calculations, the court is not convinced that plaintiffs' proof on damages shows significant "losses" to plaintiffs attributable to the marketing decision of the Arkla defendants. Moreover, the court is convinced that such

proof is not sufficient to warrant an inference therefrom that the marketing decision was imprudent and unreasonable because of any obvious, direct damage it inflicted upon plaintiffs.

19. It is the court's view that plaintiffs have not clearly shown, by a preponderance of the evidence, that the marketing decision was unsound or arbitrary. It is undenied that, after GPC 5239 was amended, the price being paid for plaintiffs' gas ($2.20/mcf) was still more than the average market price at the time ($1.50/mcf). The proof is clear that before the marketing decision, plaintiffs' gas was not being satisfactorily marketed because of the very real dispute over the terms of GPC 5239. Further, absent either protracted, expensive litigation or a marketing decision to forego insistence upon the high contract price, it was clear that none of plaintiffs' gas was going to be marketed in the foreseeable future.

20. The proof is further clear that after the marketing decision, plaintiffs' gas was sold — and at prices above the then prevailing market price.

21. This court believes and finds that when New Arkoma agreed to amend GPC 5239, thereby effectively eliminating the take-or-pay claim, no royalty triggering event occurred. No gas was then taken from the ground and sold; no cash payment was made to New Arkoma which would entitle Arkla to later take a specific quantity of plaintiffs' gas without payment of a purchase price to New Arkoma and therefore, a royalty to plaintiffs; and there was no change to plaintiffs' mineral leases or their rights thereunder.

Conclusions of Law

1. The relationship between an oil and gas lessor and the lessee under a mineral lease does not create a fiduciary duty. The lessee has not undertaken to manage and develop the mineral interests for the sole benefit of the

lessor but rather the lessee has substantial interests which must be taken into account and the lessee is not required to subordinate its own interest entirely to the interest of the lessor. The lessee must consider the interests of both the lessee and the lessor and act as a reasonable developer. *Klein*, 980 F.2d at 526.

2. In measuring the lessee's duty to market in a reasonable and prudent manner, due deference should be given to the judgment of the lessee considering actions taken by lessees under similar circumstances at the time the lessee's decision is made. *Amoco Production Co. v. Ware*, 269 Ark. 313, 319-22, 602 S.W.2d 620, 623-24; 3 E. Kuntz, *The Law of Oil and Gas*, § 60.3 (1989).

3. Since the gas prices obtained by New Arkoma in the subject gas purchase contracts, including the amendments to the contracts effective January 1, 1987, were equal to or in excess of the market prices of gas then currently being produced and sold, such marketing decision can not be properly viewed as a breach of any implied duty of New Arkoma.

4. When Arkoma entered into GPC 5239 in February 1983, the provisions of that contract satisfied Arkoma's duty with reference to the marketing of gas. Given the terms of other contracts entered into at the time, Arkoma would have complied fully with any implied obligations under its leases had it entered into a contract with a bilateral price redetermination provision that would have allowed Arkla to reduce the price or cancel the contract. Indeed, Arkoma entered into contracts with Arkla containing bilateral "market-out" clauses at about the same time, and sold its gas under contracts between Arkla and other producers where the contracts contained such provisions. In each case, Arkoma satisfied any implied duty to market gas.

5. The facts clearly show that, despite their best efforts, neither Arkoma nor New Arkoma could market gas

under GPC 5239 before it was amended. As discussed elsewhere in this opinion, this situation came about because Arkla refused to take, or failing to take, also refused to pay for the gas.

6. The Court of Appeals has stated that plaintiffs are not third party beneficiaries to GPC 5239 but, at most, they are only incidental beneficiaries with respect thereto. *Klein*, 980 F.2d at 527. No authority has been cited to the Court to support the notion that the loss of such incidental benefits amounts to a violation of the implied covenant to market which attends a mineral lease.

7. There was not, as a matter of law, any express covenant flowing from the lessee to the lessor under the leases to sue to enforce take-or-pay obligations under GPC 5239 or any other gas purchase contract.

8. Arkansas law does not recognize any implied covenant on the part of a lessee under an oil and gas lease to file suit to enforce the terms of a gas purchase contract, to which lessee is a party, for the benefit of the lessor under the said lease who is neither a party nor a third party beneficiary with respect to the said gas purchase contract.

In *Ware*, the lower court found that the failure of the operator (Amoco) to appeal an adverse decision of the Arkansas Oil and Gas Commission amounted to a violation of an implied covenant which would require Amoco to "protect the interest" of Ware. In reversing, the Arkansas Supreme Court said:

> The chancellor found that the lease had an implied covenant for Amoco to "protect the interest" of Ware, and that it breached this covenant. Essentially the chancellor found, that Amoco had a duty and obligation to appeal the Oil and Gas Commission's decision to a court of last resort. We find no such implied duty or obligation in the lease nor from the facts in this case.

> The parties had a comprehensive oil and gas lease with the usual provisions and expressed covenants. An implied covenant is one that may be reasonably inferred from the whole agreement and the circumstances attending its execution. They are not favored by the law and can be justified only upon the ground of legal necessity arising from the terms of the contract and the circumstances attending its execution. 20 Am. Jur. 2d, Covenants, Section 12.
>
> According to a leading authority in the field of oil and gas law, there are essentially five types of implied covenants in oil and gas leases: A covenant to drill wells within a reasonable time, testing the land for oil and gas; a covenant to drill test wells within a reasonable time after notice; a covenant, if oil or gas be found in paying quantities, to proceed with reasonable diligence in drilling sufficient number of wells to reasonably develop the premises; a covenant to protect the land from drainage through wells on adjoining lands, by drilling offset wells; and, a covenant to market the produce of producing wells. Summers, *The Law of Oil and Gas*, Chpt. 13, Section 395 (Vol. 2, 1959).
>
> We find no authority for the type of implied covenant the chancellor imposed in this case.
>
> *Ware*, 269 Ark. at 320-21, 602 S.W.2d at 623-24.

In this case, this court likewise finds no authority for an implied covenant flowing to plaintiffs from either Arkoma or New Arkoma to sue to enforce the provisions of a contract to which plaintiffs were not parties and concerning which they were not third party beneficiaries.

A covenant should not be implied or created to satisfy the desires of the lessor and especially to meet a situation that was not in the minds of either the lessor or

lessee at the time the lease was executed. *Wood*, 40 F. Supp. at 46.

The language of the leases is clear and unambiguous. There is nothing in the leases about "take-or-pay" claims or any responsibility of lessee to either acquire a marketing lease featuring such or to file suit to enforce such. There is no proof take either of the parties to the lease had "take-or-pay" claims in mind at the time the leases were executed.

9. The amendment of GPC 5239 and other subject gas purchase contracts did not amount to a violation of any implied duty to market gas. Prior to such amendments, plaintiffs' gas was not being properly marketed because of the stalemate between Arkoma and Arkla. There is authority for the proposition that, had New Arkoma not agreed to amend GPC 5239 so as to overcome the stalemate and get the gas flowing, such failure might have amounted to a breach of the implied duty to market gas.[8] In the court's view, the amendment of GPC 5239,

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[8] In *Frey v. Amoco Production Company*, 603 So.2d 166 (La. 1992), a case discussed and relied upon by the Court of Appeals in *Klein*, 980 F.2d at 521, it was said:

". . . the producer who failed to renegotiate a long term gas contract in the face of the pipeline's financial inability to perform fully under a long-term gas purchase contract, given the market conditions caused by the decline in the demand and the rise in producer-pipeline litigation, would also likely be deemed to have acted imprudently." *Frey*, 603 So. 2d at 176.

"More specifically, were a producer to force a pipeline-purchaser to comply with the long-term gas contract, despite the decline in price and market, it is not unlikely the pipeline would be faced with insurmountable financial problems and, eventually, forced into insolvency. (Citation omitted). The producer who forces compliance with the contract in the face of the pipeline's financial ruin, would ultimately frustrate its own primary objective of assuring a market for the gas. A financially insolvent pipeline will not produce any gas, and a royalty interest is worthless if no gas is sold. (citation omitted). Confronted with the potential loss of its market for gas, the prudent producer consents to settlement and is thus assured an uninterrupted market for gas." *Id.* at 181.

under the circumstances, was prudent and reasonable and served to properly comply with the implied duty to market gas which New Arkoma, as lessee under the leases, owed to plaintiffs as lessors.

10. Having concluded the proof does not show that the Arkla defendants breached an implied covenant to market gas, it is unnecessary for the court to reach or discuss the matter of damages. However, since proof was taken on the matter of damages to satisfy the contingency that the court might find such a breach, the court feels obliged make an observation in that regard.

Even if the proof had shown a breach of the implied covenant to market, the court would be of the opinion that plaintiffs' evidence on damages was not persuasive when considered in light of the proper measure of damages which is the "difference between what the plaintiffs have received and will receive under the marketing decision effective January 1, 1987, and what they would have actually received under some fair arrangement shown to comport with the duty to reasonably market gas." R. Maxwell, *Appropriate Damages for Breach of Implied Covenants in Oil and Gas Leases*, 42 Institute on Oil & Taxation, § 7.07, 7-24 and 7-25 (1991); R. Hemingway, *The Law of Oil & Gas*, § 8.10, 445 (1983). (*See* comments of Judge Arnold, Tr. of Opening Statements, p. 6 and Memorandum Opinion of April 11, 1991, pp. 5-6). As noted in Finding of Fact No. 18 beginning on page 52 above, the court believes the evidence on damages not only fails to support plaintiffs' contentions, but, rather, tends to be consistent with the position of the Arkla defendants that the marketing decision was both prudent and reasonable under the circumstances.

11. Based upon the court's review of all the testimony, exhibits and other matters in the record relative to plaintiffs' claim against the Arkla defendants based on alleged breach of implied duty to market gas, the court concludes that the claim must fail; that plaintiffs should

take nothing by reason thereof; and that the same should be dismissed with prejudice.

CONCLUSION

The court therefore concludes that plaintiffs' claims of unjust enrichment as against Jones and McCoy and alleged breach of implied duty to market gas as against the Arkla defendants must both fail as matters of fact and of law. Accordingly, judgment will be entered contemporaneously with this opinion dismissing said claims with prejudice.

IT IS SO ORDERED.

1/5/94
Date

/s/ Jimm Larry Hendren
JIMM LARRY HENDREN
UNITED STATES DISTRICT JUDGE

APPENDIX D

United States Court of Appeals,
Eighth Circuit

Nos. 91-1995, 91-2239

Bob KLEIN and Genevieve Klein,
John Frank Pendergrass, Sam Thompson,
Margaret Schaffer, Clymer Law, and Donnie Hall,
Plaintiffs/Appellants,

v.

Jerral W. JONES and Michael V. McCoy,
Defendants/Appellees.

Bob KLEIN and Genevieve Klein,
John Frank Pendergrass, Sam Thompson,
Margaret Schaffer, Clymer Law and Donnie Hall,
Plaintiffs/Appellants,

v.

ARKOMA PRODUCTION COMPANY, Arkla, Inc.,
Arkla Exploration Company, Jerral W. Jones
and Michael McCoy,
Defendants/Appellees.

Submitted Jan. 8, 1992.
Decided Nov. 25, 1992.
Rehearing and Rehearing En Banc
Denied Jan. 22, 1993

Lessors/royalty owners brought action against lessee/developer and pipeline company seeking payments with respect to take or pay monies. The United States District Court for the Western District of Arkansas, Morris Sheppard Arnold, J., dismissed action, and lessors/royalty owners appealed. The Court of Appeals, Van Sickle, Senior District Judge, sitting by designation, held that: (1) it was

reasonable for developer and pipeline company to make some effort to liquidate take or pay provisions in gas contract; (2) lessors/royalty owners were not incidental beneficiaries of gas purchase contract between developer and pipeline company which contained take or pay provision; (3) equitable intervention on behalf of lessors/royalty owners in gas contract containing take or pay provision was warranted; and (4) cause of action for breach of implied covenant to market gas was not time barred.

So ordered.

Bright, Senior Circuit Judge, filed concurring opinion.

Douglas O. Smith and Bradley D. Jesson, Fort Smith, Ark., argued (Rex M. Terry, P.K. Holmes III, and Lonnie C. Turner, on the brief), for appellant.

Roger W. Yoerges, Washington, D.C., argued (Gary D. Wilson, Washington, D.C. and Mark A. Moll, Fort Smith, Ark., on the brief,) for Jones & McCoy.

Jerry Canfield, Fort Smith, Ark., argued, for Arkoma Co.

Before BEAM, Circuit Judge, BRIGHT, Senior Circuit Judge, and VAN SICKLE,* Senior District Judge.

VAN SICKLE, Senior District Judge.

BACKGROUND

The events leading up to this lawsuit occurred against a background that was recently discussed by the Supreme Court. We quote from the syllabus:

> In response to ongoing natural gas shortages, Congress enacted the Natural Gas Policy Act of 1978 (NGPA), which, *inter alia*, established higher price ceilings for "new" gas in order to encourage production and carried over the pre-existing system of "vintage" price ceilings for "old" gas in order to protect consumers. However, recognizing that some of the vintage ceilings might be too low, Congress, in

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* The HONORABLE BRUCE M. VAN SICKLE, Senior United States District Judge for the District of North Dakota, sitting by designation.

§ 104(b)(2) of the NGPA, authorized the Federal Energy Regulatory Commission to raise them whenever traditional pricing principles under the Natural Gas Act of 1938 (NGA) would dictate a higher price. After the new production incentives resulted in serious market distortions, the Commission issued its Order No. 451, which, among other things, collapsed the existing vintage price categories into a single classification and set forth a single new ceiling that exceeded the then- current market price for old gas; established a "Good Faith Negotiation" (GFN) procedure that producers must follow before they can collect a higher price from current pipeline customers, whereby producers may in certain circumstances abandon their existing obligations if the parties cannot come to terms; and rejected suggestions that the Commission undertake to resolve in the Order No. 451 proceeding the issue of take-or-pay provisions in certain gas contracts. Such provisions obligate a pipeline to purchase a specified volume of gas at a specified price, and, if it is unable to do so, to pay for that volume. They have caused significant hardships for gas purchasers under current market conditions.

Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos, 498 U.S. 211, ___, 111 S.Ct. 615, 617, 112 L.Ed.2d 636 (1991).

FACTS

The named plaintiffs/appellants are the representatives of a class of about 3,000 royalty owners. Their claims derive from oil and gas leases on property located in the Arkoma Basin, in Western Arkansas. Defendant/appellee Arkla, Inc. (Arkla) is a corporation with its principal place of business in Shreveport, Louisiana. Defendant/appellee Arkla Exploration Company (AEC) is likewise a corporation with its principal place of business in Shreveport. At all times relevant, it was a wholly-owned subsidiary of Arkla, Inc., and operated as the exploration and production company of Arkla, Inc. Arkla Energy Resources (AER), while not a

named party, is a division of Arkla, Inc, which operates Arkla's pipeline.

Defendants/appellees Jones and McCoy founded Arkoma as an Arkansas corporation in 1981. Jones owned two-thirds of the stock and McCoy owned one third. Jones was chairman of Arkoma's board of directors and a corporate officer, and McCoy was Arkoma's president and its chief geologist and engineer. Arkoma was in the business of natural gas exploration, development and production. They sold their interests in the company to AEC on December 31, 1986. Jones and McCoy were joined as defendants in this action by virtue of this sale and the assignment to Arkoma, prior to that sale, of their interests in various producing wells involved.

The various Arkla entities will be collectively referred to as "the Arkla parties" or as, simply, "Arkla" unless the context otherwise warrants. In such cases they will be designated as "Arkla", "AER", "AEC", or "Arkoma".

Development in the two primary fields, the Aetna and Cecil Fields, commenced in the 1950's. Typically, mineral owners gave leases to production companies which provided for the payment of royalty based on the market value of 1/8 of the gas sold or used off the premises, or 1/8 of the amount realized from the sale at the wellhead. Many leases in the Cecil Field contained a fixed rate royalty provision which calculated the royalty at 1/8 of the value fixed at a certain amount per thousand cubic feet (mcf) of gas sold. Those fixed price leases were converted to market value leases in separate litigation in the Chancery Court of Franklin County, Arkansas, in 1990.

On December 31, 1982, Arkoma, then owned by Jones and McCoy, agreed with Arkla, a major developer in the Arkoma Basin, to purchase one-half of Arkla's leasehold interest for $15 million. Arkoma agreed to spend an additional $30 million in a drilling program over a four year period, and to share additional acreage acquired in the Aetna and Cecil Fields from other lease owners. This transaction resulted in Arkoma and Arkla owning virtually all of the rights to drill new wells in the Aetna and Cecil Fields.

Shortly thereafter, Jones became a member of the board of Arkla.

On February 24, 1983, Arkoma and Arkla executed a gas purchase contract, identified as GPC 5239, covering new wells to be drilled in the Aetna and Cecil Fields, as well as any other acreage to be acquired by Arkoma, and by which Arkla agreed to pay Arkoma the maximum lawful price under §§ 102 and 103 of the NGPA. At the time of the agreement, the § 102 price for the gas was $3.83 per mcf. The contract contained a pricing provision which allowed Arkoma to renegotiate the contract price during its term. It provided a 75% minimum take-or-pay provision by which Arkla was obligated to take 75% of the daily deliverability from Arkoma's wells, or to pay for a like amount of the gas at the contract rate[1] Arkoma committed its working interests together with all royalty interests of the appellant class to the contract.

Arkoma began an aggressive drilling program, achieving a success ratio in excess of 90%, against an industry standard of only approximately 50%. In the process, Arkoma became one of Arkla's largest suppliers of gas.

In 1985-86, Arkla curtailed the quantities of gas it took from Arkoma, but did not honor the pay provisions of GPC 5239. By March, 1986, the outstanding take-or-pay billings from Arkoma to Arkla were in excess of $36 million, and were accruing at a monthly rate of approximately $3 million. At about that time, Jones resigned from the Arkla board. Arkla then refused to pay for the gas it had not taken. Arkla calculated that it was obligated to buy 40,000 mcf per day and was taking only 12,000 mcf; that the potential

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[1] Take or pay clause A clause in a gas purchase contract requiring the purchaser to take, or failing to take, to pay for the minimum annual contract volume of gas under which the producer-seller has available for delivery. Under such clause the purchaser usually has the right to take gas paid for (but undelivered) in succeeding years. Such gas is called makeup gas. *See* Howard R. Williams and Charles J. Meyers, Oil and Gas Terms, 249 (1959), citing Howell, Gas Purchase Contracts, Southwest Legal Foundation, Fourth Annual Institute on Oil and Gas Law and Taxation, 150, 170 (1953).

take-or-pay obligation owed to Arkoma could reach $54 million by the end of 1986 and would increase by $40 million during 1987; and it determined that only 10% of the take-or-pay billings were debatable.

Arkla entered into negotiations with Jones and McCoy to resolve the problem. The negotiations for settlement of the take-or-pay obligations were resolved on December 31, 1986, when Arkla simply bought its problem. The tax partnerships, (controlled and primarily owned by Jones and McCoy), which actually owned the producing wells, assigned all of their interests to Arkoma, as did Jones and McCoy. AEC then purchased all of Jones' and McCoy's stock in Arkoma, thus acquiring Arkoma Production Company and gaining the ability to renegotiate GPC 5239. Jones and McCoy assigned all drilling interests to Arkoma in exchange for a promissory note in the amount of $35 million, guaranteed by AEC. That note was paid the same day.

"New" Arkoma, that is, Arkoma as it existed after acquisition by AEC, also agreed to furnish Jones and McCoy, free of cost to them, 5.8 billion cubic feet (bcf) of gas over a five year period. AER agreed to purchase this gas at prices beginning at $4.77 per mcf in 1987, and escalating to $6.08 per mcf in 1992. To secure its obligation to purchase this gas, AER gave Jones and McCoy a promissory note in the amount of $24 million, which was the net present value of that gas purchase contract.

"New" Arkoma agreed to pay Jones and McCoy at the rate of $1.62 per mcf for any newly established additional reserves. For the stock in Arkoma, Arkla paid Jones and McCoy, in addition to satisfying the promissory note of $35 million, a cash consideration of $14 million. The total consideration paid by Arkla on December 31, 1986, was $73 million, $35 million for the promissory note, $24 million for the gas purchase contract to buy free gas, and $14 million for the Arkoma stock.

After the sales by Jones and McCoy to Arkoma of their lessee interests, and after the sale of Arkoma to AEC, and during the period of the settlement of the take-or-pay claims and renegotiation of GPC 5239, Arkoma was wholly owned

by AEC (Arkla's production company). And AER, (the pipeline), was also wholly owned by Arkla.

On February 13, 1987, AER, AEC and Arkoma amended the price provisions and the take-or-pay provisions in GPC 5239. They reduced the contract price for gas from $3.83 per mcf to $2.20 per mcf, and released gas on the spot market for sale at prices less than $1.50 per mcf. Appellants, who knew nothing of the details of these confidential transactions of December 31, 1986, and February 13, 1987, and which the participants concealed from the Arkansas Public Service Commission, did not find out that they would be receiving less money for their royalty interests until they received their January production payments from Arkla in late March, 1987.

After Jones and McCoy directed "New" Arkoma to drill additional wells, which they were entitled to do under the December 31, 1986, transactions, the parties had a new dispute. It concerned additional consideration due to Jones and McCoy for drilling of the new wells. To resolve the dispute AEC paid Jones and McCoy an additional $100 million in 1989, which included payment for reserves, the balance due on free gas, and interest.

On December 31, 1986, the fair market value of gas reserves in the ground was 83 cents per mcf. However, Arkla paid Jones and McCoy $1.62 per mcf. The difference in the fair market value of the reserves and the amount paid to Jones and McCoy represented the value paid to Jones and McCoy to settle Arkla's take or pay dispute under GPC 5239; and to put it in a position to amend the gas purchase contract.

Plaintiffs/appellants assert, and defendants/appellees do not contest, that except for the fixed rate leases, the royalty provisions took the following basic form:

> Lessee shall pay Lessor as royalty on gas, casinghead gas, distillate, condensate, and other gaseous substance produced from said land and sold or used by Lessee off of the land or in the manufacture of gasoline or other products, the market value at the mouth of the wells of one-eighth

> (1/8) of such products so sold or used. On all gas, casinghead gas, condensate and distillate sold at the wells by the Lessee the royalty shall be one-eighth (1/8) of the amount realized from such sales.

The fixed rate royalty provisions took the following form:

> The Lessee shall pay Lessor as royalty for gas the equal one-eighth (1/8) of the value of such gas calculated at the rate of Four (4 cents) cents per thousand cubic feet corrected to two pounds above atmospheric pressure while the same is being sold or used off the premises.

Corporate Appellees' Appendix at 132 (emphasis added). As previously noted, in separate litigation the fixed rate leases were converted to market value leases. The fixed rate leases were:

> Converted into leases providing for the payment of royalties based on the proceeds received at the wellhead from the sale of the produced gas. . . . . As to the production from and after [July 1, 1990], all such royalties shall be paid by the lessees according to the proceeds, net of lawful taxes or assessments and other proper charges authorized by law or the lease agreements, if any, received by the lessees at the well for all gas produced from the leased premises. . . . Arkla warrants that the royalty payment level on its converted proceeds leases will be no less than the royalty payment level applicable to the market value leases as to which Arkla is a lessee in the Cecil Gas Field Settlement Area.

Glen Morris, et al. v. Arkansas Louisiana Gas Company, et al., In the Chancery Court of Franklin County, Arkansas, Charleston District, No. E-86-40, Final Order, Filed on May 21, 1990 (Exhibit 1 at 5).

While the briefs and the arguments refer frequently to contracts and agreements among developers and distributors--marketers of oil and gas--these plaintiffs/appellants claim as royalty owners and under leases between royalty owners and developers. And the

plaintiffs/appellants' rights in these matters must arise out of the oil and gas leases executed by the royalty owners.

PROCEDURE

The lawsuit was filed February 23, 1990. Plaintiffs/Appellees Jones and McCoy filed a motion for summary judgment January 1, 1991. The Arkla defendants/appellees filed a motion for summary judgment January 18, 1991. Each group filed its Statement of Material Facts and, on March 4, 1991 the trial court, ruling from the bench during a hearing on a motion for summary judgment, dismissed all claims against Jones and McCoy and all claims against the other defendants, except the claim based on a breach of the implied covenant to market gas. After a bench trial that lasted seven days, the court found that the action was time barred and, on April 21, 1991 entered its order dismissing the entire action. At the request of the appellants, on May 7, 1991, the court entered an order affirming the previous dismissals.

DISCUSSION

While the statements of the issues vary among the parties, the areas of concern expressed by the trial judge covered all the issues, and that outline will be followed here.

Further, in review of these issues this court will be guided by the standard that the appellate court views the case in the same manner as the trial court, *Western Casualty & Surety Co. v. National Union Fire Insurance Co.*, 677 F.2d 789 (10th Cir.1982); and we review the trial court's rulings on the applicable state law *de novo*. *Salve Regina College v. Russell*, __ U.S. __, 111 S.Ct. 1217, 113 L.Ed.2d 190 (1991). We will turn, therefore, to the bench discussion of the trial court at the hearing on March 4, 1991.

Turning now to the specific counts or claims made by plaintiffs:

1. General Breach of Duty of Fair Dealing Arising from a Fiduciary Relationship.

In *Amoco Production Co. v. Ware*, 269 Ark 313, 602 S.W.2d 620 (1980), the Arkansas Supreme Court carefully reviewed the relationship of a developer to a lessor among a

group of lessors and recited the five implied warranties arising out of the lessor-lessee relationship. It found no fiduciary relationship and it found no implied breach of fiduciary duty by lessee. Instead, it defined the duty owed each lessor, and to the lessors as a group, to act for the mutual advantage of both. It held that the lessee must act in a reasonable and prudent manner, using reasonable judgment, and not act arbitrarily.

In this case the take-or-pay elements in the developers contracts with the pipeline/marketer were, because of Federal Energy Regulatory Commission intervention, literally bankrupting the pipeline, and those facts must be considered in evaluating the reasonableness of defendants' actions. We find it reasonable for the defendants to make some effort to liquidate the take-or-pay obligations of AEC.

2. Third Party Beneficiaries.

Plaintiffs also sought relief as third party beneficiaries of GPC 5239. The Restatement defines third party beneficiaries as follows:

> (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
>
> (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.
>
> (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

Restatement (Second) of Contracts, § 302 (1981). The comments to this section provide no examples dealing with oil and gas leases.

Under the lease, the lessee's failure to perform will defeat the lessee's interest, so it follows that there is not a

continuing obligation of performance, i.e. the lessee can abandon the lease. Nor does the lessee indicate by assignment of the lease that he intended to give the beneficiary any further benefit of promised performance. Therefore, it follows that the lessors are only, at the most, incidental beneficiaries and we affirm the trial court's dismissal of this claim.

3. Tortious Interference with a Contractual Relationship.

The next claim made is that of tortious interference with a contractual relationship between the lessor and the lessee. But, the leases are admittedly assignable, and the original lessee and transferor committed no unlawful act in exercising the right to assign. We affirm the trial court's dismissal of this claim.

4. Unjust Enrichment

This court's power extends to the equity aspects of this problem. U.S. Const. Art. III, § 2, cl. 1. The doctrine of unjust enrichment, that a person shall not be allowed to profit or enrich himself inequitably at another's expense is not contractual, but is equitable in nature. Black's Law Dictionary 1705 (4th ed. 1968).

"Take-or-pay" provisions in a lease are nothing new. See Southwestern Legal Foundation, Fourth Annual Institute on Oil and Gas Law and Taxation, 151, 170 (1953). It cannot be claimed by the defendant that the parties to this lease could reasonably foresee that, under the Natural Gas Policy Act of 1978, lessors would find their market shattered by the service of mandates issued by the Federal Energy Regulatory Commission. In the course of those mandates, the market price of gas was determined not by the commercially logical principle of fitness of the gas for the purpose for which it was intended, but rather by an illogical principle related to the age of the wells.

The resulting market distortions forced the pipeline (AER) to take only the old gas, at a price level which the Federal Energy Regulatory Commission felt the customer would accept. The problems of lessor/royalty owners which arise with reference to take-or-pay clauses are generating substantial litigation as lessee/developers and

marketer/pipeline owners, seek to resolve marketing problems created in the course of administration of the National Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, which allowed gas price increases through supervised deregulation.

Three factors cry for equity intervention in this situation:

1. As shown by the legislative history of the NGPA, at no time during the development of the Act did Congress concern itself with the impact of the Act on the rights of lessor/royalty owners. *See* Legislative History, P.L. 95-621, 1978, 95th Cong., 2d Sess., reprinted in U.S.C.C.A.N. 7, 7659, 8800.

2. The artificial market distortion forced the pipeline, AER, to take the "old" gas and sell it at an artificial price to the consumers, and to abandon its efforts to honor the pay obligations.

3. Where before the purchase of Arkoma, its interest was consistent with that of the lessors, after AEC bought Arkoma its primary interest was with the pipeline, AER, because both were wholly owned by Arkla. Thus the lessors no longer had a representative dealing at arms-length with the pipeline. And lessors/royalty owners had no direct input into the making of the take-or-pay contracts since take-or-pay is a part of the developer/pipeline contract.

By its nature, gas can pass from one collection point in a reservoir to another, so a well, once opened, should be constantly tapped; and at the same time since gas is difficult and dangerous to store on the surface, and its users normally demand reliable, constant, access to it, both the developer and the pipeline want a constant flow.

As a result of the policies of the NGPA and the high demand for gas in the 1980's, and the inherent nature of gas, developers could, and did, get favorable take-or-pay provisions in their contracts. *See,* Kirk J. Brily, Comment, Royalty on Take-or-Pay Payments and Related Consideration Accruing to Producers, 27 Hous.L.Rev. 105 (1990).

But the NGPA developed the concept of "vintagizing" (i.e. classifying by the age of the wells), gas for purposes of

producer price regulation that arose under the NGPA. "Old flowing gas" was held to price ceilings far below the market clearing price of gas. This pool of artificially low-priced gas has produced "horrendous" distortions of the gas market.[2] And it was this distortion of market conditions, and efforts to adapt gas production contracts between developers and pipelines which generated the litigation before us now. See Richard J. Pierce, Jr., Lessor/Lessee Relations in a Turbulent Gas Market, 38th Oil and Gas Inst. § 8.04 (Matthew Bender 1987).

It is inevitable that as developers and pipeline marketers attempted to resolve problems of take-or-pay liabilities between themselves, the claims of royalty owners would arise.

In *Mesa Petroleum Co. v. U.S. Dept. of Int.*, 647 F.Supp. 1350 (W.D.La.1986), the Department of Interior, the royalty owner, claimed royalty on a take-or-pay payment that Mesa, the developer, had received from the pipeline. The court denied recovery, pointing out that the lease required "production" and the "pay" arose in an absence of production.

In *Diamond Shamrock Exploration Co. v. Hodel*, 86-536, slip op. (E.D.La.1986), the United States District Court reasoned that the take-or-pay payments are intended to compensate the developer for costs necessary to keep the well functioning, so they fall within the definition of "production" as activities which take place after the successful completion of the well, such as operations, monitoring, and maintenance.

The case was appealed and reviewed in *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159 (5th Cir.1988). The Circuit court rejected the Shamrock decision and held flatly that "[f]or purposes of royalty calculation and payment, production does not occur until the minerals are physically severed from the earth." *Id.* at 1168.

However, in January of 1988 the Outer Continental Shelf Lands Act (OCSLA) as administered by the Minerals

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[2] Lessor Lessee Relations in a Turbulent Gas Market, 38th Oil & Gas Institute, 8.04 (Mathew Bender 1987).

Management Service, (MMS), revised its gas royalty evaluation regulation to provide:

"The value of gas . . . sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee." "Gross proceeds" are defined as "[t]he total monies and other consideration accruing to an oil and gas lessee . . . includ[ing] but . . . not limited to: Take-or-pay payments; . . . and other reimbursements . . ." 30 C.F.R. 206.151 as quoted in *Brily, supra* [3]. The author of that comment concludes, as to MMS' position that:

> The likelihood remains remote that a court will find that the MMS overstepped its bounds by declaring that take-or-pay receipts and other consideration accruing to the lessee give rise to a royalty obligation. The MMS's [sic] position appears neither arbitrary nor capricious. The most reasonable projection is that royalties will be due on federal lease take-or- pay payments in the future.

Brily, supra, at 122.

Wyoming, as to leases where the state is the lessor, has held, by analyzing the meaning of "production", that royalties are only payable when the oil or gas is severed from the earth. *State v. Pennzoil Co.*, 752 P.2d 975 (Wyo.1988).

In Louisiana, as to state leases, the State Mineral Board has adopted a resolution addressed to the take-or-pay issue and announced that all sums "attributable to gas contracts . . . should be paid to the state along with other royalties due."

Against this background of undertakings by governmental bodies to expand the scope of "royalty" by special definitions and concepts of "constructive" production, we turn back to the problem of leases between private parties, and an equitable analysis of the meaning of "royalty" and its impact on "take" funds under a take-or-pay contract.

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[3] The 1992 CFR omits the words "take-or-pay payments".

The Louisiana mineral code, Article 213 provides that:

> "Royalty" as used in connection with mineral leases, means any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein. . . . "Royalty" also includes sums payable to the lessor that are classified by the lease as constructive production.

La.Rev.Stat.Ann. § 31-213(5) (West 1992).

Arkansas statutory law has also addressed this problem of a fair distribution of the developers/lessees recoveries in performance of its duty to market. *See* Ark.Code Ann. § 15-74-705 (Michie 1987). Arkansas law states:

> It shall be the duty of both the lessee, or his assignee, and any pipeline company, corporation, or individual contracting for the purchase of oil or gas under any oil, gas, or mineral lease to protect the royalty of the lessor's interest by paying to the lessor or his assignees the same price including premiums, steaming charges, and bonuses of whatsoever name for royalty oil or gas that is paid the operator or lessee under the lease for the working interest thereunder.

Ark.Code Ann. § 15-74-705 (Michie 1987).

The next line of cases involve four decisions arising out of the same case. For simplicity these cases will be cited as follows. The first decision, *Frey v. Amoco Production Co.*, 708 F.Supp. 783 (E.D.La.1989) will be referred to as *Frey 1*. The next in this group of cases, *Frey v. Amoco Production Co.*, 943 F.2d 578 (5th Cir.1991), will be referred to as *Frey 2*. The third, *Frey v. Amoco Production Co.*, 951 F.2d 67 (5th Cir.1992) will be referred to as *Frey 3*. The fourth decision, *Frey v. Amoco Production Co.*, 603 So.2d 166 (La.1992) will be referred to as *Frey 4*.

In *Frey 1*, Amoco, the lessee/developer, sold gas from wells of Frey and others to Columbia, the pipeline/marketer. Columbia defaulted on its "pay" obligation. Amoco had sued

Columbia in Louisiana state court; and the case was settled by Columbia's payment to Amoco of:

1. Approximately $21 million as non-recoupable take-or-pay.

2. Approximately $45 million as recoupable payment.

The Royalty owner-lessors then sued Amoco in the United States District Court for a share of the settlement. Both sides moved for summary judgment. The court denied Amoco's motion and granted Columbia's motion. The court found that Amoco had paid royalty to Frey on all gas produced and sold. Amoco paid no royalty on payments made in settlement of Columbia's failure to keep up its take-or-pay payments. And, as to the recoupment taken by Columbia, Amoco had paid royalty at its standard rate, presumably below the contract value of the recouped gas. The court held that as to the non-recoupable payment, Frey, et al., had no claim because no gas had been produced and sold. And it held that Frey, et al., had no claim as to the recouped gas because they got the market value under the long term contract of sale and therefore had suffered no injury.

The case was appealed, *Frey 2*. The Fifth Circuit Court first distinguished *Frey* from *Diamond Shamrock Exploration Co.* using the lease language. In *Shamrock* the lessor received as royalty a fraction of the "amount or value of production saved, removed or sold." *Diamond Shamrock Exploration Corp.*, 853 F.2d at 1163. But, in *Frey 2* the lessor received a fraction of the "amount realized at the well from the sale of gas." *See Frey 2*, at 581. Also, in *Shamrock* the court applied federal law to determine the meaning of the Department of Interior's lease then at issue; but in *Frey 2* the court applied the law of Louisiana, and the Louisiana Supreme Court had not spoken to the issue.

The court then held that under the language "amount realized at the well from the sale of gas", production was not required under Louisiana law. The court further held, inter alia, take-or-pay payments are part of the "amount realized" from the sale of gas under the lease, and thus such payments received by the lessee in settlement of the take-or-pay dispute

with its pipeline purchaser for gas not taken, are subject to the lessor's royalty. *Frey 2* at 580-84. The court, relying on Louisiana law, reasoned that the payments "constitute economic benefits that Amoco received from granting Columbia the right to take gas from the leased premises, a right Amoco got through the lease. *Id.* at 584. It determined "it would be contrary to the nature of the lease as a cooperative venture to allow a benefit, by any name, that is attributable to the gas under the leased premises to inure exclusively to the lessee." *Id.*

The court also held that since the market value would vary during the period of recoupment, and the lessor's royalty share would vary with it, and since $45 million was paid for the recoupable gas, the volume of gas rather than the price per each thousand cubic feet (mcf) varied; and there was no problem of computing the amount due the lessor's royalty interests.

On the take-or-pay issue the circuit court reversed the district court's summary judgment for Amoco and held the plaintiffs were entitled to their share of one-fifth of all take-or-pay payments received by Amoco. *Id.* at 586.

On a petition for rehearing, the circuit court in *Frey 3* withdrew that portion of its opinion as to Frey's entitlement to a royalty interest on the take-or-pay settlement, and certified to the Louisiana Supreme Court this question:

> Whether under Louisiana law and the facts concerning the Lease executed by Amoco and Frey, the Lease's clause that provides Frey a 'royalty on gas sold by the Lessee of one-fifth (1/5) of the amount realized at the well from such sales' requires Amoco to pay Frey a royalty share of the take-or-pay payments that Amoco earns as a result of having executed the Lease and under the terms of a gas sales contract with a pipeline-purchaser.

Frey 3 at 68.

The Supreme Court of Louisiana accepted the certification in *Frey 4* after writing that:

> The controversy centers around Frey's alleged entitlement to a royalty share of the $66.5 million in take-or-pay amounts paid by Columbia to Amoco under the Settlement Agreement. The parties characterized $45.6 million of the total as a "recoupable take-or-pay payment" and the remaining $20.9 million as a "non- recoupable take-or-pay payment."

Frey 4 at 170.

After recognizing the "fundamental principle that the lease contract is the law between the parties defining their respective legal rights and obligations" it observed that "disinclined to write a mineral lease in pursuit of equity, we are nonetheless cognizant [that] the terms of a mineral lease are neither intended to, nor capable of, accommodating every eventuality." *Frey 4* at 172. Further, the court observed:

> When the parties made no provision for a particular situation, it must be assumed that they intended to bind themselves not only to the express provisions of the contract, but also to whatever law, equity, or usage regards as implied in a contract of that kind or necessary for the contract to achieve its purpose.

Frey 4 at 172.

The court also pointed out that it cannot realistically be claimed that the lessor/royalty interest shares none of the costs or risks of development, and noted the risks of drainage and defective market forecasts are, for example, risks shared by the lessor/royalty interest. *Id.* at 178.

After finding that the Louisiana Mineral Code was not dispositive of lessor's right to take-or-pay payments, and that ". . . the terms of a mineral lease are neither intended to, nor capable of, accommodating every eventuality," it looked to the leasehold parties' general intent, i.e. that the lessor supplied the land and the lessor the capital and expertise necessary to develop the land for the mutual benefit of both parties. *Id* at 172-73. In so doing it looked to 1) the function of the royalty clause and 2) to the lessor's implied obligation to market diligently the gas produced. *Id.*

The court adopted the principle that:

> [A]ny determination of the market value of gas which admits the lessee's arrangements to market were prudently arrived at consistent with the lessee's obligation, but which at the same time permits either the lessor or the lessee to receive a part of the gross revenues from the property greater than the fractional division contemplated by the lease, should be considered inherently contrary to the basic nature of the lease and be sustained only in the clearest of cases.

Henry v. Ballard & Cordell Corp., 418 So.2d 1334, 1338 n. 10 (La.1982) (citing Thomas Harrell, Developments in Non-regulatory Oil & Gas Law, 30 Inst. on Oil & Gas L. & Tax'n, 311, 336 (1979)).[4]

In further support of the proposition that royalty owners were entitled to share in take-or-pay monies and that the basic policy of the lease required a division of the total benefits, it observed that under a lease, as a bargained for exchange, the lessor would not relinquish a valuable right without receiving something in return. The take-or-pay contract gave the pipeline (AER) the right not to take gas as well as the right to take gas; and such a right had its price. *Id.* at 173. Further, almost invariably where take-or- pay claims are settled, there are amendments to other provisions of the (sale) agreement, particularly pricing and quantity provisions, for example, a lowering of the take obligations, even though the settlement agreement clearly allocates settlement payments between take-or-pay payments and modification of pricing provisions. (*See* 23 Tulsa L.J. No. 4 1988). The lessee's action has relinquished a valuable right and the lessor is entitled to receive something in return.

> [Further, i]f producers are allowed to retain all of one part of the settlement (the lump sum payment), but must share with the royalty owners another part of the settlement (proceeds from future sales

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[4] Professor Thomas Harrell, Professor of Oil and Gas Law, Louisiana State University Law Center, Baton Rouge, La.

> under the contract), producers have an artificial incentive to maximize the lump sum settlement and minimize future price.

Richard J. Pierce, Lessor/Lessee Relations in a Turbulent Gas Market, 38 Inst. on Oil & Gas Law & Tax'n 8-1, 8-20 (1987).

The court in *Frey 4* also found that the "amount realized" encompassed the contracted sale price of the gas per mcf, the amount paid in recoupable take- or-pay payment and in non-recoupable take-or-pay payments, and in settlement and release of the take-or-pay agreement. *Id.* at 179-80.

The writings in reference to this problem show a strong, developing recognition that a restrictive interpretation of the royalties clause in a conventional lease can be inconsistent with its basic purpose, and can produce results that are unintended by the parties, and unfair to the lessor. It is hornbook law that oil and gas leases are construed in favor of the lessor, if for no other reason than that the lessor is the uninformed and inexpert party to the bargain. Summer's Oil & Gas Perm Edition Vol. 2 at 372.

We also recognize the Harrell rule, that a lease arrangement is in the nature of a cooperative venture in which the lessor contributes the land and the lessee the capital and experience necessary to develop the minerals for the mutual benefit of both parties. And it follows from that rule that:

> [A]ny determination[s] of the market value of gas which admits the lessee's arrangements to market were prudently arrived at consistent with the lessee's obligation, but which at the same time permits either the lessor or lessee to receive a part of the gross revenues from the property greater than the fractional division contemplated by the lease, should be considered inherently contrary to the basic nature of the lease and be sustained only in the clearest of cases.

Harrell, supra, at 336.

Nor is the *Harrell* analysis new or surprising. *See Brily, supra,* at 135. ". . . decisions that lessee owe royalties on non-recoupable payments . . . are legally and equitably sound." *Id.* The author supports the proposition that the royalty on recoupable payments should not be paid until gas is delivered at the well head. There the author recognizes the Harrell rule but seeks to follow the lease provision for capture where possible. *See also, Pierce, supra,* at § 8.03; John S. Lowe, Current Lease and Royalty Problems in the Gas Industry, 23 Tulsa L.J. 561; and Royalty Issues, Take or Pay Claims, and Division Orders, 24 Tulsa L.J. 511 *et seq.* Two cases applying the concept that all benefits grounded on the existence of a lease must be shared in accordance with the lease are *Amoco Production Co. v. First Baptist Church,* 579 S.W.2d 280 (Tex.Civ.App.1979) and *Henry v. Ballard & Cordell Corp.,* 418 So.2d 1334 (La.1982) where *Harrell* is cited favorably, *see* 1335 n. 10.

5. Implied Covenant to Market Gas and Statute of Limitations.

An implied covenant to market is discussed in Summer's, Oil and Gas, § 400 (1959). The writer's thesis is that, whether by specific language in the lease or by implied covenant, lessees have a clear duty to market oil and gas produced. In Ware, the Arkansas Supreme Court found five implied covenants in oil and gas leases. They are:

> [1.] A covenant to drill wells within a reasonable time, testing the land for oil and gas;
>
> [2.] a covenant to drill test wells within a reasonable time after notice;
>
> [3.] a covenant, if oil and gas be found in paying quantities, to proceed with reasonable diligence in drilling sufficient number of wells to reasonably develop the premises;
>
> [4.] a covenant to protect the land from drainage through wells on adjoining lands, by drilling offset wells; and
>
> [5.] a covenant to market the produce of producing wells.

Ware, 602 S.W.2d at 624 (citing Summers, The Law of Oil & Gas, ch. 13, § 395 (vol. 2, 1959).

The test of compliance with an implied covenant is that of a reasonable developer. In this case, the trial court found that a valid claim of failure to market had been asserted, but that it was lost as time barred under Ark.Code Ann. § 16-56-105 (1987), the three year statute of limitations. However, based on the facts, we hold that the action is not time barred.

Ark.Code Ann. § 16-56-105 provides:

> The following actions shall be commenced within three years after the cause of action accrues:
>
> * * * * *
>
> 3. All actions founded on any contract or liability, express or implied;
>
> * * * * *

The novation agreement between Arkoma and Arkla was formally executed on February 13, 1987. This action was brought by the filing of a complaint on February 23, 1990, three years and ten days later. The trial court held the three year statute applicable, found that the statute started to run when the novation occurred, and dismissed the suit as time barred by ten days. Appellants claim that it was not until March, 1987, when they received their January royalty checks, that they were put on notice of the change in their share. Appellees admit that they attempted to complete the novation of the take-or-pay contract as secretly as possible.

We recognize that the clear language of § 16-56-105 encompasses the oil and gas leases of appellants, including the implied covenant which is an integral part of such lease. The precise statutory language is "all actions founded on any contract or liability expressed or implied;". In *Scroggin Farms Corp. v. Howell*, 216 Ark. 569, 226 S.W.2d 562 (1950), the Arkansas Supreme Court observed that, "if the plaintiff, by reasonable diligence, might have detected the fraud he is presumed to have reasonable knowledge of it."

Appellants claim the statute did not begin to run until they had or, by the exercise of due diligence, should have known, the facts that gave rise to their cause of action. We agree. The statute did not begin to run until late March, 1991, and the action is not time barred.

Summary judgment in favor of Jerral W. Jones and Michael V. McCoy on all issues is reversed. The denial of dismissal as to the issue of breach of the covenant to market is sustained. The dismissal of the action on the grounds that the action is barred by the statute of limitations is reversed, and the case is remanded to the trial court for further proceedings consistent with this opinion.

BRIGHT, Senior Circuit Judge, concurring.

I agree with the excellent discussion and opinion authored by Judge Van Sickle. I add these comments relating to the right of the lessors to share in the take-or-pay settlement proceeds which Jones and McCoy received.

As a general rule, oil and gas leases should be construed in manner so that the lessee and the lessor split all economic benefits arising from the land. *Henry v. Ballard & Cordell Corp.*, 418 So.2d 1334, 1338 (La.1982); Harrell, Developments in Non-Regulatory Oil & Gas Law, The 30th Annual Institute on Oil and Gas Law Taxation, Southwestern Legal Foundation, 336 (1979). The fact that a lease conditions the receipt of royalties on the production, instead of the sale, of gas, should not annul a lessor's right to receive proceeds from take- or-pay contracts. From an economic standpoint and for other reasons, a royalty should be due on take-or-pay payments or settlement. *See* Comment, The Lessor's Royalty on Take-Or-Pay Payments and Settlements Under Gas Sales Contracts in Louisiana, 47 La.L.Rev. 589 (1987).

The express terms of the lessors' leases condition their receipt of royalties on the production of gas, and therefore they do not have a right to receive a share of a take-or-pay payment until production has occurred. This result is fair because the pipeline may eventually order delivery of additional gas under the contract to "make-up" for the earlier deficiencies. When this "make-up" gas is delivered,

for which the pipeline has already paid under the "take-or-pay" clause, the lessee will pay the lessor his share of the value of that gas, which will approximate what the lessor would have gotten had he received a share of the "take-or-pay" payment.

However, in this case, the lessee and the pipeline terminated the gas-purchase contract and settled the pipeline's take-or-pay obligation with a lump-sum payment moving from the pipeline to the lessee. Because no future purchases were linked to that payment, under a strict reading of the lease, the lessors permanently lost their rights to receive a portion of the royalties from the settlement. Jones and McCoy may have reaped a substantial benefit from the lease that purported to be unrelated to the production of gas. This result would conflict with the underlying purpose of the lease, which is for the lessor to receive a share of all proceeds generated by the land, and may have resulted in Jones and McCoy receiving a potentially unjust enrichment. *See* Comment, Royalty on Take-or-Pay Payments and Related Considerations Accruing to Producers, 27 Houston L.Rev. 105, 134 n. 225 (1990). Instead of viewing those proceeds as a windfall that the lessees (but not the lessors) received due to contractual maneuvering, a court should regard a lump-sum take-or-pay settlement as part of the proceeds arising from the sales of gas that previously had been produced under the contract. *See Callery Properties, Inc. v. Federal Power Comm'n,* 335 F.2d 1004, 1021 (5th Cir.1964) (holding that take-or-pay provisions generate proceeds from "sales" within the meaning of the Natural Gas Act, 15 U.S.C. § 717(b) (1964)). Essentially, the settlement could represent how much Arkla was willing to pay: 1) to be released from the contract; and, in effect, 2) for the gas it has already received under the contract.

Thus, with regard to the lessors' unjust enrichment claim against Jones and McCoy, a substantial question of fact exists in this case as to whether, under the leases, the lessors had a right to receive a portion of the take-or-pay settlement that Arkla paid Jones and McCoy. If the lessors should have received a share of those proceeds, then Jones and McCoy were unjustly enriched, and they may have to share a portion of that "take-or-pay" settlement with the lessors.

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

No. 90-2060

BOB KLEIN AND GENEVIEVE KLEIN; JOHN FRANK PENDERGRASS; SAM THOMPSON; MARGARET SCHAFFER; CLYMER LAW AND DONNIE HALL

v.

ARKOMA PRODUCTION COMPANY; ARKLA, INC.; ARKLA EXPLORATION COMPANY; JERRAL W. JONES AND MICHAEL V. McCOY

PRELIMINARY CONFERENCE

BEFORE: Honorable Morris S. Arnold
District Judge
Fort Smith, Arkansas
March 4-12, 1991

APPEARANCES

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[2] THE COURT: Thank you, Mr. Bailiff. Good morning, ladies and gentlemen.

The court calls the case of Bob Klein and others against Arkoma Production Company and others, which is number 90-2060 in the Fort Smith Division of the court.

Are the parties present and ready for trial this morning?

MR. SMITH: The plaintiffs are, Your Honor.

MR. CANFIELD: Ready for defendants Arkoma Production Company, Arkla, Inc., and Arkla Exploration Company.

MR. YOERGES: Your Honor, Roger Yoerges for defendants Jerral Jones and Mike McCoy, along with Gary Wilson and Mark Moll.

THE COURT: Thank you. The court has had a number of motions for summary judgment filed and also responses and replies to those motions.

I'm unable to produce a written opinion on these matters, partly because the motions were filed after the time the court indicated in its pretrial order that it would like to have them filed, although there's certainly no prohibition in filing them when they were filed, and party because, as you can see, they're somewhat voluminous.

And the questions are, at least in the beginning, fairly thorny and novel ones.

But I do have some remarks I want to make with respect to [3] these motions at this time.

I guess I'll start with the most obvious legal proposition about this case.

It's governed by the laws of the State of Arkansas, the case coming here before this court under its diversity

jurisdiction, and it is therefore my duty sitting in diversity as a federal court to make my best guess as to what a state trial court would do in these circumstances.

I say best guess, because a lot of the legal issues that are raised by the facts in this case are ones on which the Supreme Court of Arkansas has not spoken, at least directly. And therefore I have to divine as best I can from more or less oblique, rather than direct, what it is, the law of Arkansas might be, in circumstances presented by this case.

With that proposition in mind, let me simply try to characterize in a fairly simple synoptic way what I believe to be the plaintiffs' claims here.

The plaintiffs are royalty owners who had leased their production or their mineral interest to Arkoma, one of the defendants in this case, and Arkoma had marketed the gas to Arkla through a production contract case sales contract, which included a so-called take or pay clause which obligated Arkla to take a certain minimal amount of gas a year or pay for it, one or the other.

And the parties agree that because of a — now, ladies [4] and gentlemen, you're welcome to come in, but let's don't be coming in and out all the time. All right? Please come in and take a seat.

Mr. Bailiff, will you please keep the courtroom closed for the moment?

THE BAILIFF: Yes, sir.

THE COURT: Or ask them if they will please if they want to come in to sit in the back, because I can't concentrate with all this huggermugger going on here.

I've forgotten where I was. The Arkoma Company. I think the parties are agreed on these facts.

The Arkoma Company asserted that Arkla was behind in its take or pay payments, and as a result was naturally

very concerned about that, and were therefore of the view that Arkla ought to pay up, and entered into negotiations with Arkla to see that that in fact occurred.

The upshot of these negotiations was that Arkoma was sold to Arkla for a certain amount of money, a rather large sum.

I'm a little unclear why the sale was structured the way it was. It may be that as things progress I will understand that a little better.

But it was a rather complex arrangement which resulted in the exchange of perhaps upwards of a hundred seventy-four million dollars for the company, although only fourteen million dollars of that was actually attributed to the sale of [5] the company — I'm sorry — to stock in the company.

Now, it is also I think relatively clear that Arkla had in mind when it acquired the Arkoma Company renegotiating the contract under which it was seriously delinquent in its payments. And that in fact evidently occurred again. The circumstances under which this renegotiation took place are not altogether clear to the court either.

Or to put it another way, exactly what the deal was and why it was structured that particular way or not is not particularly clear to the court.

But in any event, subsequent to the sale of Arkoma and at least as a result of a plan already in the minds of the Arkla defendants, the gas purchase contract was renegotiated, and as I understand it, all the take or pay claims that Arkoma had had when it was sold were forgiven.

In other words, it was at that time that Arkoma actually released its obligations to the Arkla defendants or to Arkla, since Arkla was the buyer.

And by the way, as a kind of diversion, the court notes that this renegotiation by Arkoma and Arkla is sometimes characterized as a reformation, both by the parties in their briefs and I believe in some of the documents.

I don't mean to quibble about that but I'm going to call it a novation rather than reformation. It's a new deal.

Reformation means, as you know, has a technical meaning, [6] meaning an action by a court, not by parties to a contract. It's an action by a court to make the contract look the way the parties intended it to in the first place.

There was no problem here with the contract having looked differently from the way the parties had intended.

What happened was, there was a new deal that was struck. A novation is what it is. But as I say, that's kind of a schoolmarm's point.

Now, those are essentially the facts as I see them, and more or less admitted by the parties.

The plaintiffs have filed a complaint that contains eight counts.

Six of them I think are properly counts, that is, six of them are attempts by the plaintiffs to give the court modes of characterizing these facts in a legal way that would give rise to liability on the part of the defendants.

And I want to go through each of those counts and discuss them and give you my view of their viability.

First of all, the plaintiffs have asserted a general breach of fiduciary duty or duty of fair dealing claim against the defendants in this case.

Now, in the court's view, the Arkansas Supreme Court does not and would not recognize some sort of vague and formalist generalized fiduciary duty in these circumstances.

I base this evaluation of mine partly on the case of [7] *Amoco against Ware*, which is 269 Arkansas 313, 602 S.W.2d, 620, a 1980 case, where the chancellor in the court below had said that the lessor and the — that the lessee owes the lessor something like a duty to protect his interest, unquote.

And the Supreme Court of Arkansas rejected that idea out of hand, saying that implied covenants, quote, are not favored in the law, and that the chancellor had much too broadly characterized the duty between a lessor and a lessee.

The plaintiffs cite in their briefs some cases that I think are not particularly apt cases which deal with joint operating agreements where the parties are clear partners.

And there is of course in the law of partnership and has been for many centuries a general fiduciary duty of partners one to another.

The lessors and the lessees are not partners. Now, I'm going to say also that they're not always dealing with each other strictly at arm's length, either.

But they're not partners, and they don't owe each other what, I don't think, a generalized duty of a fiduciary character that would somehow make them, at least not to the level of the kinds of fiduciary duties that one partner owes to another.

So I don't see any breach of fiduciary duty claim here, because I don't think there's any such duty in this factual context. I'm going to dismiss that count.

[8] Secondly, the plaintiffs have characterized these facts as ones that would give rise to a cause of action under a third party beneficiary claim.

I gather, I think, if I've interpreted the plaintiffs correctly, what they're saying is that they were third

party beneficiaries to the gas purchase contract between Arkoma and Arkla.

The court believes that this is not a characterization that the Supreme Court of Arkansas would accept.

It is true that the royalty owners benefited from the contract, but I believe that the Supreme Court of Arkansas, following general common law principles, would hold that the royalty owners are merely incidental beneficiaries of contract and not such beneficiaries as have rights under the contract.

I think it's enough to refer you to the Restatement of Contracts Second, Section 302, which announce these principles. The Supreme Court of Arkansas frequently follows the Restatement.

But in any event, the Restatement here really does nothing more than give new names to familiar common law friends of ours, namely the so-called creditor beneficiary and donee beneficiary.

Briefly, a third party beneficiary may — or for some reason the Restatement wants to call these people contract beneficiaries — can maintain actions.

[9] That is, they have rights under contracts to which they are not parties, if the idea behind the contract was to extinguish an obligation that was owed to those beneficiaries, or if there was an intention to make a gift of the benefit of the contract by the promisee. That's just not this case.

And so I think, without belaboring that, I think it's quite clear that the Supreme Court of Arkansas would not find that the plaintiffs here were third party beneficiaries of this gas purchase contract between Arkoma and Arkla.

I'm going to skip over to the fourth count here by the plaintiffs, because I think for the same reason the fourth count also has to fail.

It's essentially a restatement of the ideas that are contained in the second count, but here the plaintiffs give the activities of the defendants a tortious cast by claiming that there was tortious interference with contractual relationship.

Here, in my view, there was no contractual relationship between the plaintiffs and the defendants that could have been interfered with by the actions of the defendants.

Now, it may be that the defendants, or rather one of them, Arkoma, had a — I'm sorry — yes, Arkoma had the contract with the plaintiffs.

But a breach of that contract, if there was one, can't be characterized properly as a tort.

[10] If there was an arrangement between Arkoma and the plaintiffs — and there was, of course, because they had a lease — then any breach of that arrangement is simply a breach of contract, nothing more.

It's not a tort. You cannot convert a breach of contract into a tort for the purpose, for instance, of attracting exemplary damages or whatever.

I mean, we've got to keep that boundary up. If we don't, then what we've got is a sort of generalized law of obligations. And we don't have that, at least not in this country.

So I'm going to dismiss the second and fourth counts.

Let me move on to count five, unjust enrichment. Plaintiff cites some interesting recent cases by the Supreme Court of Arkansas and Court of Appeals in Arkansas, both of which announce fairly commonplace

results accommodated by the common law of unjust enrichment.

I think this is probably the place for the court to make some remarks about the question of whether royalties are due when a take or pay contract is settled or extinguished by the acts of the parties.

The briefs are full of a lot of argument about whether or when this take or pay contract was settled, whether it was settled when Arkoma was sold and Mr. Jones and Mr. McCoy got money for their stock and some other things, or whether it was settled when in fact Arkoma entered into a new agreement with [11] the Arkla companies.

It seems to me that, to the extent it makes any difference, the contract was an asset of Arkoma that was sold when the company was acquired by Arkla, and it was then renegotiated.

But I don't think it matters, at least not on this level, when or if the contract was settled, because I don't think the plaintiffs have a right to any portion of the proceeds of a settlement of a take or pay obligation.

First of all, though there aren't many cases on the subject, the ones that do exist, except I believe perhaps for one district court holding in Oklahoma, make it clear that there's the proper result. There is no Arkansas case on the subject, not that I've been able to discover, anyway.

It doesn't seem to me, secondly, that a situation where either there's a jury verdict on a take or pay controversy or a settlement of a take or pay controversy is any different from the situation where the owner of a take or pay contract receives payments, whether recoupable or not recoupable, from the other party to the gas sale contract.

It's quite clear, the cases are quite clear, and I think they're quite well reasoned, that in that situation there's no royalty that's due, for the simple reason that there hasn't been any sale of the gas. There has simply been a payment of money.

[12] And the leases in this case, at least so far as I've been able to determine — of course, if there are things here that I say of a factual character that you all don't think are properly reflected in the record as it's now developed, you'll let me know, I'm sure.

But I think almost — if there's anything that's settled under Arkansas law or the law of any gas and oil producing state, it is that a royalty owner doesn't get any money unless the gas is produced.

And there's no production here. There's no production if the purchaser simply makes a take or pay payment and doesn't take. There's no production if there's a settlement of that take or pay obligation. There's no production if there is a lawsuit over a take or pay obligation and if you go to verdict or judgment by a court.

Now, the plaintiffs characterize this notion that the defendants have raised as simpleminded. Maybe it is. But that's what's usually called argument on the other side that's really good and is not liked.

I might also be simpleminded, but if so, maybe that's the reason it appeals to me. I don't know. But it seems to me this is a fairly obvious argument and one that I accept.

So I don't see how there could be any unjust enrichment here. What the defendant Arkoma has done is receive money for an obligation that was owed to it. It was simply about its [13] own business when it sold its assets.

The typical situation where unjust enrichment or quasi contract is at home is where the defendant has gotten

some benefit, as by the labor, very typically, as, for instance, from the labor of somebody else, and there's no contract between them to fix their obligations, and therefore the law creates a quasi contract, which means of course as a remedy this would be the same as if, quasi, there were a contract.

Here, it is true that the plaintiffs have provided their property, in a sense, but there's a contract between them that fixes their rights.

We don't have to pretend, quasi. We don't have to resort to these fancy notions of quasi contract because there's a contract there.

Quasi contract, restitution, unjust enrichment, shared benefits, all of those are ideas of an interstitial character where you don't have a tort or a contract that fixes the rights of the parties.

And yet it seems in justice — that is, in justice, — one party owes money to the other.

I don't see this as a situation that the Arkansas Supreme Court would characterize as one involving ideas of restitution at all. So I'm going to dismiss that claim too.

Now, the sixth count that the plaintiffs have is violation of Act 222 of 1929. This is a mysterious statute.

[14] But I think that the plaintiffs — I'm sorry — the defendants have at least shown some light in some dark corners by pointing out that the statute, at least in Section 704 and 705, contemplates an in kind royalty.

It contemplates, it seems to me, those situations in which the production company, the owner of the working interest, the seller, is dealing on his own behalf — and not because of some implied obligation, but because of the way things work — he's dealing, selling his gas and he's also selling the lessor's gas.

And in that situation, what the statute says is, you can't sell your gas for more than you're selling your lessor's gas. You've got to get the same price for the two gases.

Now, isn't it obvious that this statute, whatever it may mean in section 708, and I'll get to that in a minute, seems to be dealing with a situation in which there's production of the gas and there's a sale of the gas, not sale of an obligation owed to the company that has the right to market the gas, but a sale of the gas itself, a production of the gas.

It seems to me that's pretty plain. That's not our situation, as I was at some pains to say earlier.

Now, I know there's some loose language in a recent Arkansas case that seems essentially to characterize the sale of the lessee's interest in gas in a way that might give rise [15] to a kind of royalty interest. But that can't be right.

That would mean that every time a lessee sold his lease-hold that there would be a royalty, which is plainly absurd. All you'd have to do is sell it eight times, you'd be slap out of gas. So it's crazy. That doesn't make any sense, and nobody can possibly believe that.

Now, the section 708 of that act does have a sort of generalized idea that's sort of quasi contractlike in that somehow whenever buyers of gas from lessees, let's say, whenever lessees receive money for gas, that they can't receive over their proportionate share, it says, is my recollection of the language.

I've looked at that section of the statute wondering what in the world it could mean. But I think it contemplates an actual sale of the gas under circumstances that would ordinarily trigger a royalty, a right to moneys received on account of gas delivered, in other words.

That seems to me what proportionate share means there. Again, it contemplates, for instance, a situation in which the lessee might sell his gas and the lessor's gas and keep all the money and not give the lessor his share. I think that's the kind of situation in which the statute is at home.

And a lot of the words themselves are sufficiently elastic that I certainly do understand how the plaintiffs would think that it was a good argument.

[16] It is a good argument. I think I would have made the same argument too. It's just not one that I've accepted. I think that the statute simply doesn't apply to these kinds of situations.

And I believe in fact that the essential reasoning of the *Hillard against Stephens* case, 276 Arkansas 545, 1982 case, probably recognizes that fact, though I certainly understand that that case — I wouldn't say it didn't have anything to do with our facts. It's not certainly a case that deals with our facts in any meaningfully direct way.

I think the concurrence in that case really comes closer to coming to grips with what this statute might mean, if I may say so without offense, than the majority opinion does.

Well, that leave us with count three, which is a breach of the contract to market gas, implied obligation to market gas.

I do believe that the Supreme Court of Arkansas would recognize that duty. I believe that the Supreme Court of Arkansas would recognize an implied duty on the part of lessees to market gas.

While the Supreme Court has shown some hostility to implied covenants, as I've indicated, from the case of *Amoco against Ware*, I think that nevertheless this is one that is so well recognized in other jurisdictions —

and it may have been alluded to by way of dictum in *Amoco against Ware* as well, [17] because, as I recall, the court, quoting from Charlie Myers's treatise or somebody else's, said that there are these five recognized covenants, and that may have been one of them.

But I don't really have any difficulty at all concluding that there is an implied duty to market gas on the part of lessees in these kinds of factual context that I think that the Supreme Court of Arkansas would recognize. That's well established elsewhere. It's been alluded to in dictum by them. It's not a great step to that covenant from one, for instance, that the Supreme Court of Arkansas has recognized from very early times, namely, the duty to explore, exploit the resource.

It's I think fairly inherent in the relationship. No big step from duties clearly already recognized by the Supreme Court of Arkansas to this one.

So I think that this is at least a viable theory under the context, and I think that the contours or perimeters of this duty would probably be similar to the ones that the Supreme Court of Arkansas has already imposed with respect to the duty to make explorations.

Here I have reference to the case of *Ezzell against Oil Associates, Inc.*, which is 180 Arkansas 802, a 1930 case where the Chief Justice Hart said that a lessee must, quote, proceed for both of them, meaning lessor and lessee, and must not consider his own interest wholly, or for the most part, even.

[18] I suspect that this is the same kind of language that the Supreme Court of Arkansas would find appropriate in describing whatever this kind of loose duty is, namely to market gas in a reasonably prudent manner, in a way that will at least take into account the interest of the royalty owners.

By the way, this language was quoted with approval in *Poindexter against Lion Oil Company*, 205 Arkansas 978, a 1943 case.

Now, I don't know whether the interest of the royalty owners were consulted in any meaningful way when Arkoma made its new deal with its parent company or not.

It may be that the answer to that question is hidden somewhere in these red notebooks, but you'll forgive me if I confess that I haven't read everything that is in those red notebooks. I simply didn't have time.

Also, the defendants here have brought the court's attention to the fact that the statute of limitations applicable to this kind of action is a three-year statute.

I think that's correct, based on the case that Doctor Professor and Mr. Justice Leflar wrote, which seems fairly clear that despite the fact that the obligation is to be found in a written agreement, it being one that itself, according to the reasoning of this case — I realize there are cases in other jurisdictions to the contrary — but according to Mr. Justice Leflar's reasoning, that's an obligation that's [19] not in writing, and therefore the appropriate statute of limitations is three years.

Now, I don't believe the defense was pleaded, was it?

MR. CANFIELD: Yes, sir, it was.

THE COURT: I'm sorry. I didn't see that in your answer. Whether it was or not, I think I would nevertheless like to hear proof at the very least on questions of estoppel and laches and fraudulent concealment that the plaintiffs have raised.

And also I note, I believe that the Arkla defendants claimed in their brief and they said in a footnote that it was — subject to proof of course — that in fact the royalty owners here were better off as a result of this

arrangement. And I would be interested in hearing proof on that.

I guess it would depend somewhat on the question of what the likelihood was of the lessors ever getting anything out of this take or pay arrangement.

I just don't know. And of course, that depends on the value of that cause of action, really, and not just what Arkoma got for it in the sale, but what its actual value was, though of course what it got for it in the sale is some evidence of what it was. By that cause of action, I mean of course the cause of action that Arkoma had against Arkla for the take or pay obligation.

But that's something that I obviously am not ready to [20] rule on. I haven't heard proof on that.

So I think what we've got left here is a cause of action not for royalty, but rather for breach of contract, a consequential damages action, in other words, for breach of contract, which may or may not be subject to a good statute of limitations defense.

Now, let me move on for a moment to deal with the question of whether Mr. Jones and Mr. McCoy are still in the case, because they have filed a separate motion for summary judgment, having dealt generally with the causes of action.

They've moved separately for summary judgment on the ground, essentially, that all of this happened, that everything's that actionable, if there's anything that's actionable, happened after they were out of the picture, and also, although they make this argument only in a footnote, also on the ground that they're not liable anyway, because if there were any duties that were breached at any time, they were duties owed, if by anyone, by Arkoma and not by them individually. I agree with both of those arguments.

What's left here, as I said, is a breach of an implied duty to market gas.

This is not a duty that Mr. Jones and Mr. McCoy ever owed anybody. They never had any contract with Arkla. Arkoma owed that duty if anybody did. And therefore they couldn't possibly be liable.

[21] Now, it's an interesting question, seems to me, whether this result ought to change if Mr. Jones and McCoy knew that Arkoma was going to renegotiate this contract and somehow participated in — the plaintiffs would say conspired in — getting this novation completed.

Mr. Jones and Mr. McCoy say that there's no evidence that they knew, no evidence in the record.

I don't know whether that's true or not, but I don't think it matters, because I don't think that — well, I was going to say I don't think that there's such a thing as aiding and abetting a breach of a contract.

But I suppose that it might be a tort. It might be that a theory left to the plaintiffs would be tortious interference with a contract, namely with the contract that is clearly between the plaintiffs and the defendants here, namely, the implied covenant to market gas.

This is not a theory that I had thought of before now, because I don't think it was ever characterized that way.

I believe that the plaintiffs's tortious interference claim was a claim that their third party beneficial right in the contract between lessor and lessee — no, I'm sorry — in the contract between Arkoma and Arkla had been interfered with.

But I suppose that under these facts a claim might be made out that Mr. Jones and Mr. McCoy — I'm not holding this [22] as a matter of fact, obviously — but a claim might be made here that Mr. Jones and Mr. McCoy

had interfered with the right of the lessors to have their gas marketed by Arkoma, a duty that is a contract right which they in fact do have, not as party beneficiaries but as lessors.

I don't believe, Mr. Smith or Mr. Jesson, that you all actually pleaded that as a cause of action, did you?

MR. JESSON: Your Honor, I'd have to review the pleadings. I think you're essentially correct.

THE COURT: I believe that the tortious interference claim was one not on the ground of interfering with an implied obligation in the lease but rather on the ground of interfering with an alleged third party beneficiary right that the lessors have in the gas sales contract. Isn't that right, Mr. Smith?

MR. SMITH: The court is asking whether we have pled or argued that Mr. Jones and McCoy's conduct was solely related to the third party or the gas purchase contract as opposed to their duties related to, growing out of the lease, implied duty to market. I'm not sure that I wouldn't suggest that it was related to both, Your Honor.

THE COURT: All right. Well, I think maybe on that narrow ground I will keep Mr. Jones and Mr. McCoy in the case.

I don't think that actually the pleaded causes of action here — well, I'm going to dismiss all the pleaded causes of [23] action.

But I think this is a cause of action that lurks in the facts sufficiently to give notice to the defendants of the possibility of arguing it.

Do you understand what I'm saying? I mean, is this an intelligible noise? I'm not asking you to like it. I wouldn't expect you to like it. I just want to make sure you comprehend it.

It's kind of like taking a guilty plea. The first thing you do is make sure the defendant understands what you're saying and what the charge is.

I just want to make sure you understand, comprehend what I've said. Whether it's right or not is a different matter altogether.

So I guess what we've got left of the case is that all the defendants are still in, either because they may have breached an implied duty of a contractual character to market gas in a reasonably prudent manner, or because they may have under these facts combined with two parties to a contract — well, may have urged one party to a contract to breach it, which would be a tortious interference.

Yes, sir?

MR. CANFIELD: Your Honor, with reference to Arkla, Inc. and AEC, I would contend that they should be out altogether and that the action should be solely against [24] Arkoma.

THE COURT: Well, they might be liable on this tortious interference claim too — theory. I just don't know enough about the facts.

But it's clear to me from the deposition excerpts that I saw that the people at Arkoma knew what they were going to do when they — I mean people at Arkla knew what they were going to do when they bought Arkoma, because they characterized it as a buydown. We're going to get rid of this obligation.

So I think they knew about that.

And if getting rid of that obligation amounts to a breach, then I think that activity on their part could be characterized as a tortious interference.

MR. CANFIELD: And perhaps that argument could be made with reference to Arkla, Inc. and its pipeline AER, but how could it be made with reference to AEC?

THE COURT: Well, they're in because — well, AEC?

MR. CANFIELD: Yes, sir. AEC is the other — you know, they own the interest in these leases. There's no claim that they breached their duty to market gas. They became the owner of the stock of Arkoma in the transaction, but I don't see how that would make them liable.

THE COURT: Well, if they were urging the breach, if they were involved in urging the breach.

MR. SMITH: If the court please, along that line, [25] clearly in our pleadings and throughout the presentations, one of the, we feel obvious, is Arkla is all one and the same. They've got the same people. AEC is the company that bought Arkoma. According to some of the testimony, Arkoma didn't even have a separate board. Same officers. They did it all.

Then they enter into contracts with AER back and forth. It was all done in one thing.

Suffice it to say, we think clearly the allegations are sufficient, the evidence in these motions, and the evidence we'll present here will justify collapsing, if I may use that term.

And let me also say, Your Honor, in connection with your previous remarks with reference to Jones and McCoy, we think the evidence, the allegations in effect show that Jones and McCoy were the alter ego of the old Arkoma.

They got the benefits. They decided what would be done. They represented to Arkla that they owned — when they owned it and it was Arkoma, and so we —

We don't take issue with the court's rulings. We just want the court to understand that that is and always has

been a contention, and there's proof and will be additional proof before the court.

THE COURT: Well, if you can produce proof that somehow they ignored the corporate form, for instance, that the corporation was a sham or something of that character. [26] And of course you're certainly privileged to do that. But there was no suggestion in any of the proof that I saw in this case that there was any reason at all to ignore the corporate form in this kind of case.

MR. YOERGES: Your Honor, this claim for relief that has arisen now from the complaint against Jones and McCoy, from what I hear the court saying, is intentional or some sort of tortious interference with the contract that existed between Arkoma and the lessors, that is, the oil and gas lease.

THE COURT: Yes, sir.

MR. YOERGES: I'm curious whether you could provide us with the benefit of what the contours of that claim would be in these kinds of facts, as it is sort of a new thing that has come out now.

By that I mean, would it merely be the knowledge that Jones and McCoy had that something might happen to Arkoma's contract?

For if that were the case, it seems to me that shareholders of any production company that decided to sell their company because they'd just had it with the buyer of the gas, whether they sell it to the buyer of the gas or whether they sell it to Exxon or Amoco or anybody else, with the full knowledge that the subsequent purchaser is likely going to do something in the way of a novation or perhaps just an outright [27] rescission, cancellation of the contract, it would seem that the reach of this claim for relief would in essence envelope everybody like Jones and McCoy who sold their company. I'm curious whether it's — if it's just knowledge.

I think the evidence in the record right now is undisputed that the Arkla defendants never negotiated, never discussed with Jones and McCoy what the terms of any kind of reformation was going to be, if indeed Arkoma would continue just to force Arkla to sell the gas at those high prices and somehow try to pass through the corporate ladder some sort of profits because of that.

THE COURT: I think probably knowledge wouldn't be enough, mere knowledge, but anyway, you said they didn't know. Knowledge is certainly necessary, but I don't think it's sufficient. I think that they would have to make the way easier in some fashion or other.

I don't know what the contours of it would be, because I just thought it up.

I'm just a little reluctant, having had the thought, to abandon it, you know, almost as quickly as I invented it. But I do see your difficulty.

One would think that it would require — I mean, I'm reasonably clear that it would require something more than mere knowledge, because, as you say, anytime a lessee got rid of his contract, if that were all, knowing that the people on [28] the other end were perhaps going to commit a tort with it or at least breach it, that that would somehow make that assignor liable. I think that's probably too extravagant.

I think the proof would have to show some encouragement of some sort, perhaps helping in the planning of how to do it, whether it was, you know, exactly how it was going to happen, something like that.

MR. YOERGES: Planning the breach itself, which would be the novation.

THE COURT: Yes. Exactly how to breach it, as it were. I hope that helps.

MR. YOERGES: I think it does.

THE COURT: Are there any questions? Now, let me deal with another matter that Arkla had pleaded, namely, this release.

I think the release on its face very clearly saves any claims that might be made in this case. I'm not sure that I understand how Arkla can maintain that this release is somehow a bar to this action.

MR. CANFIELD: Your Honor, the precise language of the release is that the participants in the Cecil Field settlement gave up all claims other than one claim that they saved, which they were permitted to pursue in this case.

The one claim which they were permitted to pursue in this case is the claim that they are entitled to a share of the [29] considerations paid to Mr. Jones and Mr. McCoy.

And additional to that specific language, the release further provides that they give up all claims for any royalties or moneys from the Arkla parties arising out of the leases in issue up to the time that the fixed price leases were converted into proceeds leases as of production on July 1, 1990. And if they have any claims for royalties under those leases or any claims arising out of these transactions, the 1986 transactions, if they have any claims as to those, they have released them, saving a right to claim a share of the moneys paid to Mr. Jones and Mr. McCoy, which they could claim ——

THE COURT: You're saying this is not a lawsuit, no longer, at least, a lawsuit for a claim of the share received by anybody? It's simply a lawsuit, at least what's left of it in the court's mind, that claims damages for breach of contract?

MR. CANFIELD: That's correct. And as to that, they specifically gave up any claims as to how their royalties were to be paid up to the date of July 1, 1990.

And that would certainly include the period in which the court has found the plaintiffs are entitled to go forth and try to prove a breach of duty to market on January 1 or in February of 1987.

MR. TERRY: If Your Honor please, we entered into [30] that release of course in the previous litigation in Franklin County, Arkansas last year.

As part of the appendix, I believe, Your Honor, it's appendix entry number fifty-two in support of the plaintiffs' response to the defendants's motions for summary judgment which is our combined response.

This release is set forth in two forms. First, the long form, the release that was signed, and second, a duplicate of that release that was — it's not a precise duplicate, but it was the mailing which went out to all the class members.

The form of the notice to the class members was approved by Arkla's counsel upon a joint motion filed before Judge Mobley who did approve the form of the notice.

The court will recall that the release goes on to precisely state that all the class members who are releasing their claims in that case are preserving their claims in this case.

And Your Honor, we named this case, and I believe we also identified it by case number, because this case had already been filed and was of record at the time that other settlement was entered into.

THE COURT: Of course, it says alleged share of the so-called take or pay settlement.

MR. TERRY: That's correct, Your Honor. But I believe that those same damages are involved, if there is a [31] case here for consequential damages for breach of contract, as this court has now limited the cause of

action, I believe that would include considerations paid for any alleged take or pay settlement.

I think we're talking about the same damages, in effect, just a different cause of action than what perhaps everyone had in mind, because this complaint, at least before this morning, existed in about eight counts.

THE COURT: Right. But it does say insofar as seeking recovery of. It doesn't say in which they are seeking recovery of.

I'm not going to grant summary judgment on this ground, Mr. Terry, mainly because I think the intention of the parties are fairly clear that they wanted — that this lawsuit was exempt from the release. But it's — well, you have your record.

MR. MOLL: Your Honor?

THE COURT: Yes, sir, Mr. Moll?

MR. MOLL: If the claim of tortious interference against Jones and McCoy as to the oil and gas leases had been raised by the pleadings, that certainly would have been a portion of defendant Jones and McCoy's motion for summary judgment, and it would have required plaintiffs to come forth with what evidence they intended to introduce to meet that burden.

[32] THE COURT: Right.

MR. MOLL: Wouldn't it be fair to all parties to perhaps give the plaintiffs a brief break and ask them to make a proffer or proof on what evidence they would use to prove the cause of action as the courts construed it.

The court could look at that and basically determine whether or not that would be sufficient.

THE COURT: Well, of course, it may also be true that the plaintiff was surprised by the invention as well, in which case I'm not sure they would be prepared. But I shouldn't be speaking for them, obviously.

Mr. Jesson, Mr. Smith, do you have a reaction to Mr. Moll's suggestion?

MR. SMITH: May I speak to Mr. Jesson?

THE COURT: Would you all like a brief recess?

MR. CANFIELD: I think it would be wise, Your Honor.

THE COURT: All right. We'll be in recess.

(Recess)

THE COURT: Thank you, Mr. Bailiff. Good afternoon, ladies and gentlemen. Welcome back. Thanks for your promptness.

I believe what we had on the table when we recessed was a suggestion by one of the defendants, two of the defendants, Messrs. Jones and McCoy, that the plaintiffs be required at least to make some kind of Rule 56 proffer or proof they would [33] expect would establish a claim in the nature of tortious interference with the implied covenants in the lease.

And I was wondering whether the plaintiffs have come to a resolution of whether they think that's possible at this time. Mr. Smith?

MR. SMITH: With the court's permission?

THE COURT: Yes, sir.

MR. SMITH: The plaintiff class understands, Your Honor, the rulings of this morning and believes it understands the court's comments with reference to individual defendants Jones and McCoy and suggestion of Mr. Moll with reference to a proffer of proof.

The plaintiff class has had a brief opportunity to consider the court's remarks and rulings and Mr. Moll's request.

I'm confident the court can understand that we have not had an opportunity to do it in depth, nor have we

had an opportunity to collect and offer the proof by live witnesses as such.

However, with the court's permission, I would like to make some statements with reference to the anticipated proof.

And I realize there may be some controversy about some of them, and I would hope that the court at some point in this juncture of the trial would allow my co-counsel to supplement as they see necessary.

[34] THE COURT: Yes, sir.

MR. SMITH: Your Honor, we feel, or suggested this morning that the doctrine of alter ego, if I may refer to it as that, and the observations about the potential claim under tortious interference are intertwined, and therefore with the court's permission I'm going to comment briefly on both.

With reference to the alter ego or the contention that Jones and McCoy were in fact old Arkoma, if you will, we feel confident, we feel the proof will show that Mr. Jones and Mr. McCoy between themselves owned one hundred percent of the corporation. I believe they were its only directors. They made all the decisions for the corporation.

The proof will further show that they owned, they, McCoy and Jones individually, at least two-thirds of the working interests or reserved rights that are the subject of this litigation and the subject of the transactions with Arkla and its affiliated companies.

We believe the proof will show that Jones and McCoy personally, for their personal preserves, interests, got, of the hundred seventy-four million, they got all but fourteen million, which was the stock transfer, and it went directly to them.

We think the proof will show that there were various alternatives discussed to resolve the take or pay controversy, and it was ultimately done in a sale fashion, as it ultimately [35] turned out, in a large measure, because this was a tax-driven decision by Jones and McCoy to their own personal tax benefit.

We think the evidence will also show that for reasons we still don't completely understand, but I know the court's aware of it, that it was Jones and McCoy individually who entered into the gas purchase contract on or about December 31, 1986 as a part and parcel of this, for which they got high prices, four to six dollars for gas that was allegedly carved out, and had rights to receive in the future other considerations.

We think the evidence will also show that Jones and McCoy individually obtained from other tax partners, owners of working interests, their interests, and in the course of that obtained assignments from these tax partners of all their rights under all the gas purchase contracts.

And Jones and McCoy, in turn, when they assigned, under the asset purchase agreement to Arkoma, assigned or you might say waived any and all of their rights under the gas purchase contracts.

We think the letter offers exchanged between MR. Jones to Mr. Warren, and Mr. Warren to Mr. Jones, both of which occurred in November of 1986, show the personal involvement of Jones and McCoy as opposed to their corporation.

And we also feel that the evidence of Mr. Warren, which [36] will be presented when we begin, or during the course of his testimony, will show that from his perception, that the contract, particularly 5239, was owned by Jones and McCoy, Arkoma being a shell.

Turning to, if I may, Your Honor, evidence in addition to that that might be directed or relevant to this tortious interference approach as opposed to the other claims we've asserted, which have now been dismissed.

We anticipate that the evidence will show Mr. Jones and Mr. McCoy had fundamental and basic knowledge of all the transactions and a complete history of the take or pay controversy, were directly involved in it, and were negotiating with reference to it.

We think the proof will show that they caused bills for take or pay liability, including the interests of royalty owners, to be sent by Arkoma.

Once again we point out that they, as well as other tax partners, assigned their rights under the contract as a part of the asset purchase agreement.

We anticipate the evidence will show that Jones and McCoy sold their own reserves, as well as their own royalty interests that they owned, and collected for them under this transaction.

We think the evidence will show that there were a number of alternatives available, were considered during the [37] negotiation, if you will, between Jones and McCoy on one hand and Arkla on the other, and that Jones and McCoy decided, rather than litigation or these other settlement potentials, they would effect it through a sale mechanism, and, if you will, let Arkla worry about the problem.

We think Mr. Warren's testimony will indicate that from his perception Arkoma was just a shell corporation and that what Arkla did was just purchase the problem, that is, all the problems attendant to the cash contracts.

And the corollary to that, of course, is, Mr. Jones and Mr. McCoy sold the problem, and would not only have knowledge but would be directly involved in the efforts to resolve it by what has been referred to as reforma-

tion, perhaps more accurately, as the court describes it, novation.

THE COURT: What evidence do you have of their knowledge and participation in the novation?

MR. SMITH: We have no knowledge that they sat on January 1, or no evidence, and said Arkla, AEC, AER, change this contract.

We have evidence, some of which I've indicated, that they know what the problem was.

THE COURT: Well, of course. I mean, that's well known. They were trying to get rid of it.

MR. SMITH: Well, with all respect, Your Honor, I hadn't finished my list. May I come back to that, Your Honor?

[38] We believe the evidence will show that they never discussed or considered the royalty owner impact.

We believe that Mr. Jones, who sat on the board of Arkla from 1983 until February of '86, when he was in essence asked to resign, knew that the history of Arkla was to resolve or get rid of these take or pay controversies. And the implications are that they would this one when he sold it.

And further, this points up the fact that he was personally aware of the conflict between producers, in this case old Arkoma, and Arkla, the buyer.

We think the evidence will show that Mr. Jones and Mr. McCoy wanted the wells turned on and the gas purchased, they said.

And had that happened, the royalty owners would have received their royalty, it's assumed. But they decided to sell it instead of stand up or persist on that.

All of which is to say that — Mr. Jones's testimony in earlier depositions has indicated that he knew Arkla was

buying the production, and it was a method of solving the problem, and that money is what it's all about.

We believe that, while Mr. McCoy, in his sworn testimony in the Hoover Wilson case, said that he didn't learn about the reformation until six months before his deposition, which would be late '89 or early '90, that in fact he was aware of the reformation well in advance of that.

[39] THE COURT: I'm sorry. Who is this?

MR. SMITH: Mr. McCoy. In fact, his employee Mr. Mitchell, who's subpoenaed here to testify, has testified that he told him in March when he learned about it and started sending checks to the royalty owners.

We feel the evidence would show that Mr. McCoy and Mr. Jones, who are experienced in the oil and gas business, particularly as producers, would have some knowledge of the implied duties of producers to royalty owners and knew that Arkla, upon the resolution of the problem, did not intend to acquit those responsibilities.

We would call the court's attention to the fact that one of the exhibits in this case, I believe it's identified as Exhibit #93, is a letter from an attorney with Wilmer, Cutler and Pickering, who is counsel of record for Jones and McCoy in this case. Does the court want to —

THE COURT: I don't have that, unless it's an exhibit to the ——

MR. SMITH: It's in the books to your left there, Your Honor. Excuse me, your right.

THE COURT: It's an exhibit to the — no, these are the exhibit books here, the trial exhibit books.

MR. SMITH: It's also an exhibit in the other book. #93 is a trial exhibit, Your Honor.

THE COURT: Okay.

[40] MR. SMITH: By way of background, that's a letter from Wilmer, Cutler, and Pickering, in this case, a MR. Lapin, as counsel for Jones and McCoy, to Mr. Drushel of Vinson and Elkins, counsel for Arkla.

THE COURT: I don't think I've got the right exhibit here. Let's see. All right. I've got it. I think it's #93, isn't it?

MR. SMITH: Yes, sir, it's #93.

THE COURT: I'm sorry. I thought you said #94.

MR. SMITH: Anyway, if you will, Your Honor, that's a letter from Wilmer, Cutler and Pickering, as counsel for Jones and McCoy, to counsel for Arkla, and it was written in the context of the controversy about the proveup and some of that.

At page six of that exhibit, Your Honor, there is footnote two, if I may refer to that.

It says, "Second, as you know, this case was a compromise of a take or pay case; if we had not settled this case, Arkla would have had to pay three dollars and forty cents per mcf for gas from JMC that had a free market value of only a dollar fifty."

We think that tells the story, Your Honor, that they knew that when they sold the company, sold the problem, that it was Arkla's intention, and their — and one of their bargaining tools in selling the company, to put Arkla in the position to [41] reduce the price from three dollars and forty cents to in essence what the spot price was, a dollar fifty, and that's exactly and precisely what happened, Your Honor.

We think there will also be evidence that while in fact——

THE COURT: This letter — who's — Bill is evidently William H. Drushel; is that right?

MR. SMITH: Yes, Your Honor. He's representing Arkla and the Arkla interests.

THE COURT: I don't think there's any question that Arkla knew what it was going to do.

MR. SMITH: Yes, sir, but this letter, the author of this letter represented Jones and McCoy.

THE COURT: Okay.

MR. SMITH: And he is telling the Arkla people that the whole deal was a take or pay settlement, and if you hadn't entered into it, you wouldn't have been able to reduce the price from $3.40 to $1.50.

And we would suggest, Your Honor, that that shows that, even though Mr. McCoy said he was not aware of it, certainly aware what the transaction was and what the result was going to be.

We would also point out, Your Honor, that, coming also from Arkla as evidence, they put out in their 10K, which was published at or about that time, that the reformation occurred [42] prior to 12-31-96, or as a part of the 12-31-86 transaction.

And then Mr. Warren, who's the president of AEC, has previously testified that the reformation took place before. Now, it's given that Mr. Warren has now recanted and said he's wrong, but it certainly shows a perception.

Mr. Warren has also indicated, as have other Arkla representatives, that the contract that Jones and McCoy go for gas was a, quote, part of the reformation, same reformation about which we now complain.

Your Honor, that is a list of potential evidence that we believe will or can come in in line with what we've now been restricted to with reference to Jones and McCoy, and that is tortious interference.

I'm sorry I haven't given you page and number, but we've done the best we could to come up with this. Again, if any of my co-counsel would like to supplement that, I'd ask the court to allow them.

THE COURT: Thank you, Mr. Smith. Anything further from plaintiffs on these particular issues?

MR. JESSON: I have nothing, Your Honor.

MR. TURNER: No, Your Honor.

THE COURT: All right. Mr. Moll?

MR. MOLL: Your Honor, may I defer to Mr. Yoerges?

THE COURT: Yes, certainly.

MR. YOERGES: Your Honor, I hesitate to say that we [43] would virtually stipulate to everything that Mr. Smith has just put on the record in the way of a proffer to support the claim for relief for some kind of intentional interference with implied covenant in the oil and gas lease.

I think all of this is irrelevant. I think the evidence is undisputed in this case that Jones and McCoy would not reform the gas purchase contract, which is the principal contract at issue here. They would not release the take or pay claims.

Arkla, despite its best efforts, despite putting on the table a variety of different alternatives to do that, was unsuccessful.

And as a way to resolve the problem, in the most literal sense, Jones and McCoy decided what they would do is do exactly what Mr. Smith said, and that is, sell the problem to Arkla.

When they did that, the contract was intact and all the obligations that Arkoma had to its lessors went along with that sale.

THE COURT: I made that point this morning.

MR. YOERGES: So it seems to me that the quintessential issue here is whether there is some kind of evidence that the plaintiffs can adduce that indicates something beyond just knowledge on the part of Mr. Jones and Mr. McCoy that Arkla was intending to reform the contract.

[44] And I think, despite what Mr. Smith said, that there is nothing that he has indicated he would proffer that shows any more than that they knew that perhaps Arkla would reform the gas purchase contract. Now, the——

THE COURT: There's no evidence of any kind of participation or advice or, as it were, civil conspiracy.

MR. YOERGES: I don't think there's any evidence whatsoever and certainly any evidence of an intentional interference with the relationship between Arkoma and these lessors in the kind of way that's required under Arkansas law to make out such a claim for relief.

In a case that Mr. Moll tried before this court, a Phillips case, this court articulated——

MR. MOLL: That's a painful recollection. Even coming from my co-counsel, that hurts.

THE COURT: You could have talked all day without citing that case, Mr. Yoerges.

MR. YOERGES: Well, I almost did cite it, but there's no style on this, but I know the——

THE COURT: Well, it'll have four or five citations before it's done with, I assure you.

MR. YOERGES: All of which will be put on the record, I hope.

THE COURT: Yeah.

MR. YOERGES: The court said in its instructions to [45] the jury — and this is particularly on the issue of intentional interference with some sort of contract or business

expectancy — it said to the jury, "If you find that in making the decision not to allow branding of all the Spe-Dee Mart locations, Phillips was acting in its own fair interest based upon reasonable economic and business considerations and not with intent to cause injury or damage to Robertson, then Phillips was justified in its actions and has not improperly interfered with a business relationship."

I think the evidence here is that Jones and McCoy were looking out for two people: Jerry Jones and Mike McCoy.

When they decided to sell this company, they tried to get the best price that they could possibly get for the sale of the company.

Now, the fact that they structured the transaction with a variety of different agreements, as the court alluded to earlier today, is really irrelevant. All of the money came to them as the sole shareholders of the company.

I don't think there's any evidence that in the course of doing that, unless the court were to say that something about that is inherently tortious, then I don't think there's any evidence that once Arkoma was owned by Arkla Exploration Company, that Jones and McCoy did something further in the way of interfering with the implied market, implied obligation to market.

[46] They didn't sit down at the table and kibitz about what the terms of the reformation were going to be for the novation.

They didn't talk about whether Arkla should in fact make a payment to Arkoma, whether in fact Arkoma should turn around and share some of that with the royalty owners. They were completely out of the picture at that point.

I think the evidence is completely clear that Jones and McCoy did not intentionally interfere with any business expectancy of the lessors. Thank you.

THE COURT: Thank you. Anything by way of reply from the plaintiffs?

MR. SMITH: I didn't know whether Mr. Canfield was going to say anything, Your Honor.

THE COURT: Mr. Canfield, have you got anything you'd like to say? This is really a matter that concerns Jones and McCoy, is it not?

MR. CANFIELD: It is, Your Honor. Could I confer just a minute, please?

THE COURT: Certainly.

MR. CANFIELD: We have nothing, Your Honor.

THE COURT: All right. Thank you. Mr. Smith?

MR. SMITH: In reply, Your Honor, in behalf of the class, we would respond primarily by making this observation and/or argument:

[47] Clearly, there were negotiations going on. Mr. Yoerges has now said Jones and McCoy did not negotiate about the price or do anything about the contract to modify it.

Notwithstanding, as they were both individually and as the alter ego of the corporation under a duty to impliedly market the gas of our royalty owners, rather, they refused and insisted on a sale, knowing certainly what was probably likely to happen. And after it happened, the benefit they got was paid for their gas, their seven-eighths, if you will, at the contract price.

THE COURT: All right. Thank you, Mr. Smith.

I think, from the proffer that the plaintiffs have made with respect to the possibility of making out a claim from the evidence of tortious interference by Messrs.

Jones and McCoy individually, as opposed to Arkoma as a corporation, that the court will dismiss the remaining claim against Mr. Jones and McCoy. Because I don't think mere knowledge — all the plaintiffs have shown is possibility of mere knowledge.

And by the way, I think from the circumstances and the experience that these gentlemen had, rich experience that these gentlemen had in the oil and gas business, it would be open to a fair-minded factfinder to infer that they knew what was likely to occur.

Nevertheless, as I said this morning, mere knowledge isn't enough.

[48] Now, Arkoma, it might be that their knowledge could be imputed to Arkoma.

But of course, you know, it doesn't really matter whether you knowingly breach a covenant, whether it's an implied covenant or an express covenant. The only question is whether you do breach it.

The question of whether Arkoma has breached their implied covenant to market gas is still very much an open question.

Also, I think that the proffer of proof that the plaintiffs made with respect to its invitation to the court to ignore the corporate form in this case and essentially to find that Jones and McCoy were Arkoma, in the sense of the same juridical entity, I think that evidence would not allow the court to do that either.

There's no evidence here of there not being regular meetings of the corporation. There's no evidence here of commingling of personal and corporate funds. There's no evidence of a custom of ignoring the corporate form by individuals.

It's well known that individuals can own all the stock and be all the officers and yet there still be a corporation

which has juridical significance and is a separate and distinct entity from the parties.

It's true that this sometimes has the effect of providing a kind of shield of legal immunity between the corporation and [49] individuals, but that's one of the points of corporate form.

I don't see any evidence here from the proffer or from the pretrial briefs or exhibits that this corporation was a sham. It seems to me it was a very real corporation.

Of course, as we know, corporations are juridically fictitious. They're fictitious persons. But I think this was, if this isn't an oxymoron, a real fictitious person and not just a sham.

I have on occasion, as you may know, ignored corporate forms, did so recently, but that was where there was proof that there was simply no real existence to the corporation at all, that the person who really ran the outfit simply treated everything that came into the corporation as his very own. Under those circumstances, the court was quite clear that a finding that the corporation was a mere shell or a sham was appropriate.

Not under this proffer.

So I'm going to dismiss the remaining claim against Messrs. Jones and McCoy, which I believe effectively removes them from the case, does it not? Are there any questions?

MR. SMITH: We had an agreement with counsel that Mr. Jones and Mr. McCoy would be available to testify in this case. We assume that will carry over?

THE COURT: I would certainly think — I mean there's——

[50] MR. SMITH: We'll work with you on timing if——

THE COURT: I would assume that that agreement is something that would transcend them being parties. And

if you have any problem with that, of course, I'll issue subpoenas.

MR. MOLL: Thank you, Your Honor. We get the message.

THE COURT: If I were you, I'd just live up to your agreement. Perhaps I could just specifically enforce it. In any event, I believe those gentlemen should be made available.

Again, if there's any difficulty, just apply to the court and we'll make sure that's done.

I want to revisit now briefly, before we go to the motions in limine, this business of the release, talk a little more about it, because it's——

MR. MOLL: Your Honor, may we be excused?

THE COURT: You may.

MR. SMITH: May I be excused to visit with Mr. Moll a minute?

THE COURT: Yes, sir.

* * * * * * *

I CERTIFY THAT THE FOREGOING IS A CORRECT TRANSCRIPT FROM THE RECORD OF PROCEEDINGS IN THE ABOVE-ENTITLED MATTER.

4-22-91
Date

/s/ Amy L. Aston
Amy L. Aston
Official Court Reporter
Western District of Arkansas
Fort Smith Division